Cotton Outlook

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Contents

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‘Open to the World’

By Mr. Ray Butler, President, International Cotton Association, Limited

Open to the World, as a conference theme, is a clear reference both to the current state of play and the enduring ambition in ICA. Any bona fide buyer or seller of cotton, in whatever context (producer to ginner, ginner to trader or mill, trader to end user) is welcome to join the ICA and, indeed, is encouraged to do so, as indeed are those who provide ancillary services to the cotton and textile sectors. This year, as Kai Hughes, our managing director, explains, a new membership structure has been introduced which is geared to reducing the cost of membership for the majority, to establishing specially-reduced rates for textile mills, and to encouraging other Associations to join with the ICA in pursuit of our overarching goal – sanctity of contract.

As an arbitral authority, the ideal would, in our view, be no requirement for arbitration. The ideal is unrealistic since, regrettably, disputes in commercial contracting are from time to time inevitable, particularly in periods of high price volatility. Hence the need for a strong set of international trading rules, one to which all parties can subscribe as a basis for their contractual arrangements. The aim of the ICA Bylaws and Rules is to set the framework, to create a default position, whereby each party knows what will happen if contract fulfilment is not achieved. This does not mean to say that contracting parties are prohibited from making different provisions for specific requirements, as long as both agree, and provided such agreement is clearly stated in a contract. So, it is imperative that contracting parties know what it means when a contract states “subject to the Bylaws and Rules of the International Cotton Association”, or similar, and understand their rights and obligations.

The ICA offers a training course, Complete Cotton, which is an ideal way of gaining a fuller understanding of the issues surrounding contracting and arbitration, as well as a broad understanding of the functioning of the world cotton market. Subject to financial and manpower resources, furthermore, the ICA is willing to travel around the world to deliver subsets of this course, on demand.

That is just the start of it, as far as we are concerned. Today, our Board consists of 21 people from 14 countries, representing spinners, cotton traders and ancillary sectors, and we actively seek participation in both our committees and at director level, from as broad a cross-section of the industry as possible. After all, for rules to be seen to be fair and balanced, for the ICA to be seen as impartial in its dealings – which it most assuredly aims to be - every opportunity should be taken to engage a multiplicity of industry participants in our affairs.

What does ICA membership bring? Firstly, and perhaps most importantly, an ICA member can be expected to be held in respect by their peers in the industry, as an entity that shares our creed and our aims, and therefore be seen as a potentially reliable trading partner; secondly, there are distinct cost advantages should arbitration prove necessary; thirdly, our members have the benefit of access to impartial advice on procedure, should that be required; fourthly, all our events, wherever they are staged, give privileged access of some description to our members.

In Dubai, for instance, members have been given the benefit of a reduced registration fee to participate in the event; Complete Cotton costs much less for members, than for others; in October, members coming to Liverpool for our Annual Trade Conference and Dinner will not only pay less, but will also be able to participate in the first Annual General Meeting to be held in conjunction with our prestigious yearly event.

Many times in my experience, criticism of the ICA has come from quarters where our objectives are misunderstood, or from those unwilling to take part in open debate and who have not been inclined to give their time to try to achieve what is surely right – a contracting system that is fair to all, in which everyone can have input, and which is indeed *Open to the World.*

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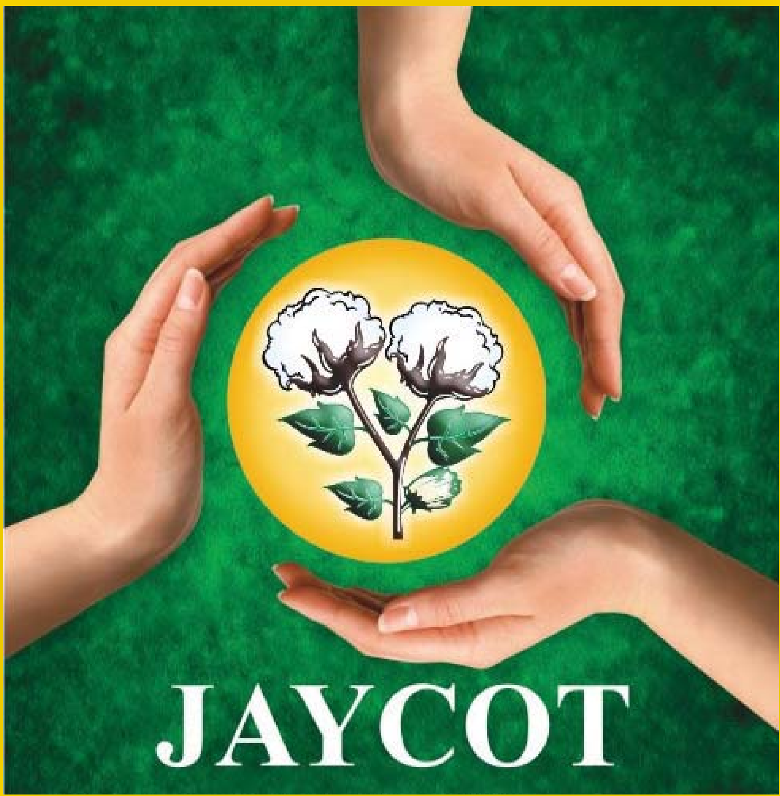

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Dubai – The Cotton Expressway

By Mr. Krishnan Ramamurthi, Director, Dubai Cotton Centre, DMCC

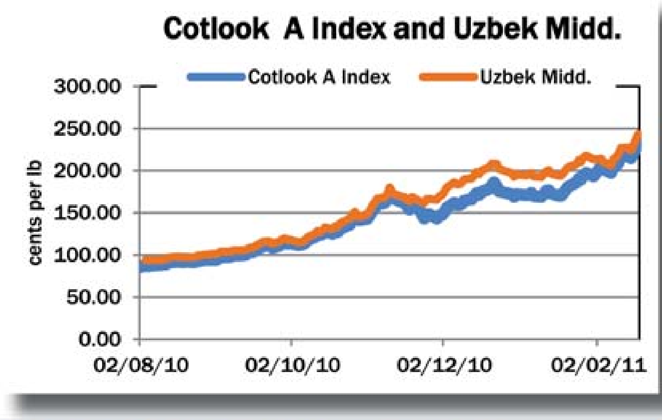
Why Dubai

Dubai has emerged as one of the leading gateways for international commodity markets. Geographically located at the crossroads of the Commonwealth of Independent States, India, Pakistan, and Africa, Dubai's crucial shipping route allows it to function as a hub into the consuming markets of the Middle East and Far East. A sound currency, tax free environment, welcoming approach to foreign investment, a modern banking infrastructure, as well as excellent seaport facilities and its proactive approach to maintaining competitiveness and connectivity are just some of the key attributes that continue to allow Dubai's thriving commodities sector to grow. Being neither a producer nor a consumer, Dubai provides a fresh breath of neutrality to the cotton trade which is key to achieving its goal of becoming a global commodity hub.

Dubai's Cotton Initiative

Dubai's initiative to position itself as a hub for international commodities has been brought about the establishment of the Dubai Multi Commodities Centre Authority (DMCC), the only dedicated commodities focused free zone authority in the Middle East. The DMCC's proactive approach in implementing the strategic initiatives of the Government of Dubai includes establishing a dedicated market place for diamonds, pearls, gold, tea, and more recently in 2008, for cotton. Leveraging its close ties with the Republic of Uzbekistan, the Dubai Cotton Centre (DCC) was officially launched subsequent to a visit by the Uzbekistan President, His Excellency Islam Karimov to the United Arab Emirates. From this state visit a dedicated trading platform for the marketing and promotion of Uzbekistan cotton exports was created, utilising Jebel Ali Port as a key link in consolidating the cotton supply chain.

Since the of signing a framework agreement with its Ubek partner two years ago, the DCC has since re-exported over 50,000 MT of Uzbek cotton fibre with a CNF value of USD $100m. Through this framework the DCC has exported to some of the leading mills in Bangladesh, China and Malaysia. It aims to expand its export network to more destinations in the Far East during the coming years. Catering to the growing requests of its clients, the DCC has shipped 750 metric tons of organic cotton to Malaysia.



Major OIC Cotton Producing Countries

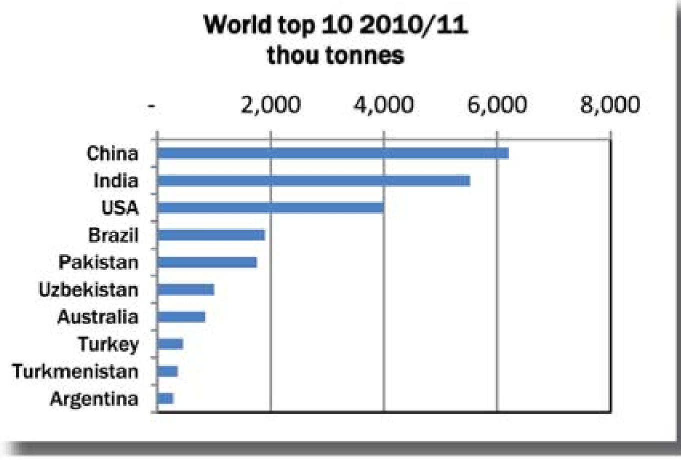
	Production (000 MT)	Share in World (%)		Production (000 MT)	Share in World (%)
Pakistan	2,145	8.6	Cote d'Ivoire	109	0.4
Uzbekistan	1,208	4.9	Cameroon	90	0.4
Turkey	773	3.1	Nigeria	87	0.4
Syria	327	1.3	Benin	82	0.3
Burkina Faso	294	1.2	Sudan	81	0.3
Mali	223	0.9	Azerbaijan	71	0.3
Turkmenistan	212	0.9	Chad	71	0.3
Egypt	201	0.8	Kyrgyz Rep.	46	0.2
Kazakhstan	147	0.6	Mozambique	36	0.1
Tajikistan	136	0.5	Togo	30	0.1
Iran	115	0.5	Senegal	20	0.1
			Total	6504	26.2

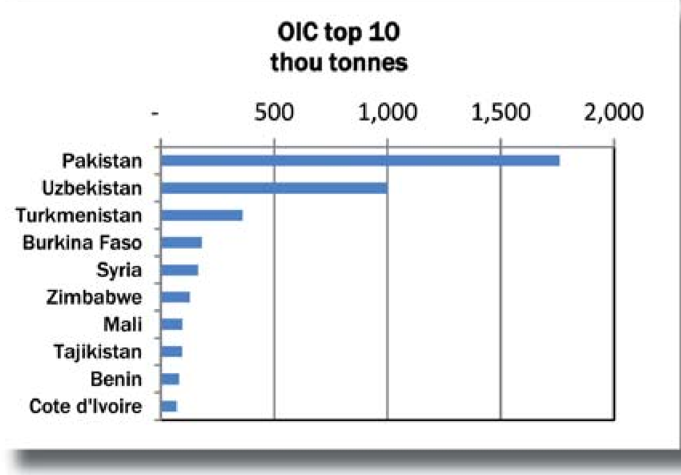
To further facilitate the cotton trade, the DCC has developed useful products and services including: Real Time Fixation on spot inspected volumes, pre and post landing inspections, total logistics solutions, and specific banking instruments to address client's needs. Due to the fact that the DCC is part of the DMCC, it is able to take advantage of other value added products and services provided by its parent. Good examples of this are the award winning Global Multi Commodities Receipts system, the free zone status enabling 100% foreign ownership, and dedicated real estate which enables foreign entities to establish themselves and trade efficiently in Dubai.

The Modern Silk Road

The Republic of Uzbekistan has vast natural resources and minerals and has been an established trading hub since the Silk Road era. It is currently ranked as the world's third largest cotton exporter. Producing around 1,200,000 tonnes of cotton fibre and exporting almost 800,000 tonnes annually, it has since established itself as a formidable and reliable exporter. Since gaining independence in 1991 the cotton industry in Uzbekistan has developed significantly both domestically and in production for export. This includes an efficient logistics system with 21 specialised cotton terminals, including 6 bonded

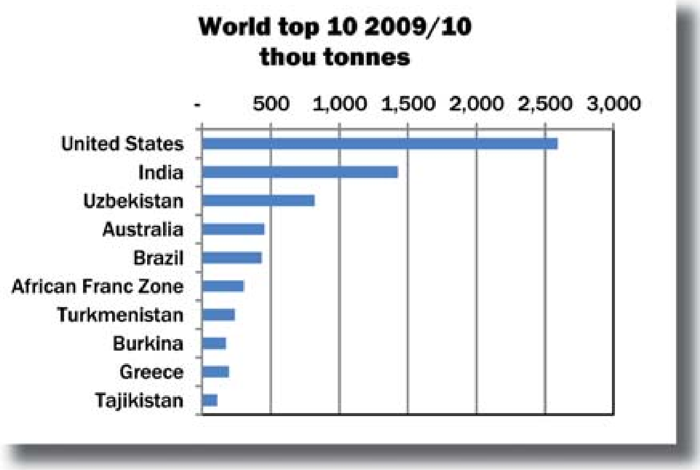
Production

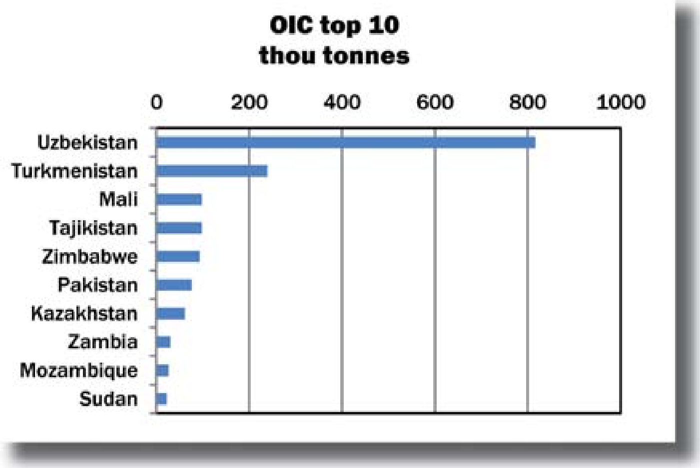





WE'RE ON THE MOVE....

Exports





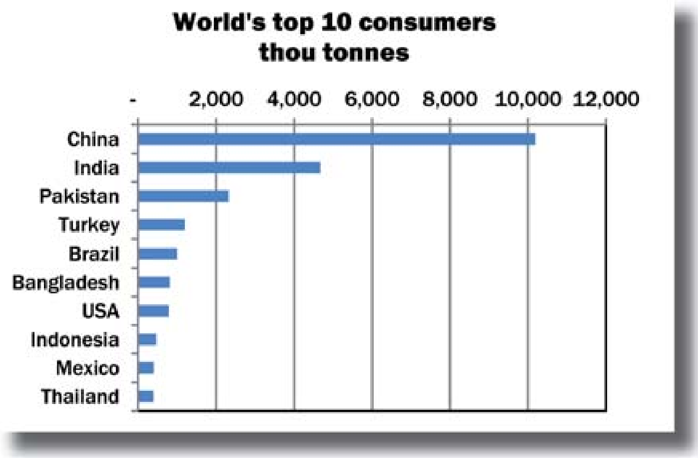
warehouses, capable of storing a volume of up to 400,000 tonnes. Realising the significance of China's consumer market, it has since streamlined its delivery operations through Alashankou in the Chinese province of Xinjiang. Uzbekistan's cotton marketing initiatives include the annual Uzbekistan Cotton Fair of which the DCC is an integral part. Over the last seven years, the domestic yarn production capabilities have been significantly developed with foreign entrants investing in Uzbekistan and establishing high technology yarn production units. This has resulted in a gradual and steady decline in exports. The quality of Uzbek cotton is renowned for its staple length and strength that makes it a premium product. This is attributed to the research and development undertaken by the cotton managing authority, Uzpakhtasanoat and the standards that have been implemented by SIFAT, the State authorised inspection agency. Dubai's co-operation with Uzbekistan is a natural strategic fit to manage the flow of trade to the consuming countries in the Far East.

The World of Cotton - Now

The price volatility and surges have evidently turned a new page in the history of cotton. The new pricing levels we have witnessed across the world are not a paradox but the result of cumulative factors. The spot prices of cotton for Q2, and Q3 2011, currently hinge on the export quota of India. Actual realisation of overly anticipated Indian cotton shipments due in Q1 this year, has since fuelled cotton prices higher, into uncharted territory. Robust yarn prices and continued export requirements in the textile exporting hubs have sustained demand. Short supply in the spot markets has been attributed to climatic force majeure experienced in Pakistan, China, Australia and more recently Brazil. Lower then expected crop yields also add to the equation. The challenges faced by the mills in Asia mean that they must meet their production requirements but must also achieve a sustainable average procurement price for the financial year 2011. In addition they must cover their working capital requirements to meet their production capacity. These factors continue to fuel a bullish market view which we are currently seeing. Purchases will continue to be of smaller consignments. US cotton exporters have sold most quantities stretching past Q3. Q2 and Q3 will be dominated by cotton exports from India and Uzbekistan.

Continuing the White Gold Journey

These historical developments in the cotton trade have impacted the cotton trading and the consumer community in more ways than imagined. They further underline the importance of reliability of contracts made and reduction of counter-party risk. Operationally, mills are gearing themselves strategically to be more efficient by means of technical integration and procurement policies to cope during these challenging times. Asia will continue to be a major hub of textile production for export markets, owing to its skilled and competitive labour, lower operational costs and established strategies. Uzbekistan will continue to be a major global exporter of quality cotton, and likewise, the industry will continue to appreciate the consistent nature of Uzbekistan's volume. Rising working capital requirements will spur innovation in the field of structured trade financing for both traders and mills. Dubai is well positioned to add value to the cotton trade with its progressive leadership, business-friendly environment and excellent logistics, adding yet another precious commodity to the United Arab Emirates in the form of cotton, to which the name of 'white gold' is appropriate.



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2011: A Critical Year for the ICA

By Mr. Kai Hughes, Managing Director, International Cotton Association

There is no doubt that 2011 is going to be critical in the future direction and development of the ICA. Our efforts to create a more diverse organisation and Board will be tested by the response to our new membership structure, which was launched on 1 January 2011. This new, more affordable membership structure has been constructed to encourage more mills and producers to join the ICA and to play their part in its future development. In addition, we are in discussions with a number of cotton associations to discover ways in which we can work in partnership and work together to promote training, the use of ICA Bylaws & Rules and, more importantly, contract sanctity.

Open to the world

The 'Dubai 2011' event at The Ritz Carlton International Financial Centre will be the ICA's first major gathering of 2011. The signs are that the event is going to be even more popular than Singapore 2010 and the theme, 'Open to the World', underlines our ambition to be a truly global association – one without frontiers and one that represents the international cotton community, wherever they may be.

Dubai 2011 also reinforces our continued commitment to Asia as the world's major cotton consuming region and, if we fast forward to 2012, we have decided to host our traditional annual trade dinner event in Hong Kong. This will be another milestone for the ICA and a break with tradition, as the event has always been held in Liverpool, UK.

While the city remains the historical home of the ICA, and the intention remains for the event to be held there from time to time, we recognise a need to be closer and more accessible to the major markets. We plan to make our 2011 trade dinner in Liverpool this autumn a memorable event, to which everyone is cordially invited. Next year, we trust, Hong Kong will attract many of those who cannot, for various reasons, usually make it to Liverpool, together, perhaps, with an even bigger attendance from mainland China than at our conferences in Singapore and Dubai.

Improving effectiveness and reducing costs

Looking ahead to the future and at our core business, it will be of no surprise that we will be continuing to improve the transparency and effectiveness of the ICA arbitration system. Soon, parties will be able to securely access information about their arbitration via the internet - including updates on how the arbitration is progressing. This will initially be trialled on Technical Appeals, but it should be available for all arbitrations by the end of the year.

We will continue to put forward proposals to reduce the costs of arbitration and the length of time they take to complete, as we know this is an area where we need to make major improvements. However, it may surprise you to know that in 2010 the average time taken for an arbitration was 98 days and the average cost was GBP £6,461. Going forward, these times and costs will be made available on our website so you will be able to judge for yourself if we are making progress.

Training also features heavily in our commitments for 2011. Following on from the success of the ICA arbitration workshops in Bangladesh last year, we will be holding further workshops throughout the year and, thanks to your feedback, we have developed a workshop specifically aimed at agents. Also new for 2011 is our 'Advanced Level Arbitrator Training', which has been introduced to ensure that ICA Arbitrators are trained to the highest possible standard. The training is for ICA members who have passed the Basic Level 1 examination and who want to improve and develop their arbitration knowledge and skills.

Our 'Complete Cotton' training course has now been totally revamped. Focusing on key areas of the raw cotton trade - from growing to spinning and everything else in between, this year's course is already a sell-out - we have received over 50 applicants for 35 places.

On the move

2011 will see us move from our premises in the Cotton Exchange to newer and more modern offices in Liverpool. The Cotton Exchange has been our home since 1906, when it was built by the Liverpool Cotton Association and opened by the then Prince of Wales. We sold the building in the early 1960's and have been a tenant ever since. We will obviously be sad to leave, but we are looking forward to the move and are confident that it will enable us to continue to improve our service to our members.

In 2008 the news was all about the unprecedented volatility of the markets. Nearly three years on that volatility has become several times more intense and now, more than ever, there is the need to build relationships based on trust and respect. This is where we can help. The ICA exists to protect the legitimate interests of all those in the cotton trade. Our events are the catalyst for bringing together the diverse range of organisations and professionals that make up our industry. We want Dubai 2011 to be a success – strengthening existing business relationships and helping to develop new trade opportunities for all delegates. If we achieve this, it will take us closer to our goal and help position the ICA as the only truly global cotton association that is 'open to the world'.

Liverpool Cotton Exchange

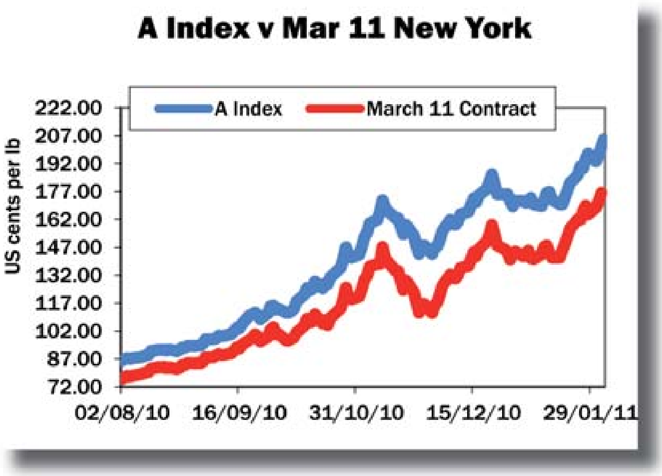
The World Cotton Market

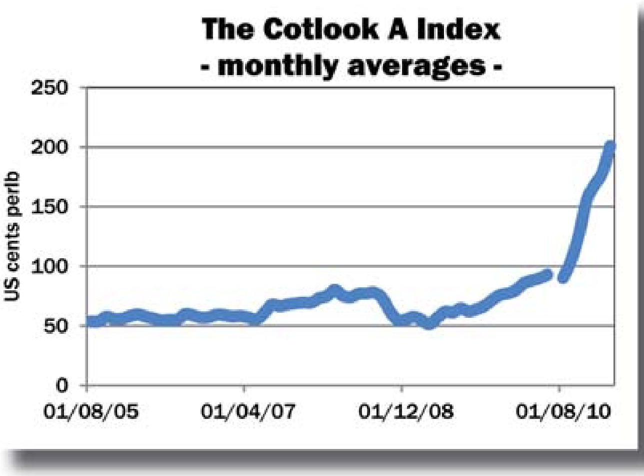
By Cotlook Editorial Staff

Supply & Demand

Since the gathering last year in Singapore, when the world was trying to shake off the worst of the preceding year's financial crisis, and cotton was still less than one US dollar per lb, the cotton market has gone through unprecedented times.

New York futures, driven at times by inflows of speculative funds seeking a haven in face of weakness in equity markets and the US dollar, have reached new heights and speculative activity (much to the consternation of the authorities) has clearly been a strong factor influencing the Chinese markets. The 2009/10 Cotlook A Index was withdrawn earlier than usual last year, for want of sellers' offers of certain growths, and the current season has seen last year's advance pale by comparison. Various factors have come into play on the supply side, including government intervention in markets (such as in India), floods in some countries (Pakistan earlier in the season, Australia more recently) and other adverse influences on final 2010/11 crop yields. Tightness of supply and strong demand have driven the A Index to successive, record levels, and the Index has fully reflected both the bullish mood of the trade, and its general unwillingness to cede ground on basis relative to futures. By late January, for instance, the A Index premium on the nearby New York contract month was variously between 20 and well over 30 US cents per lb, the latter being more than three times as much as that prevailing at the beginning of the 2010/11 season.



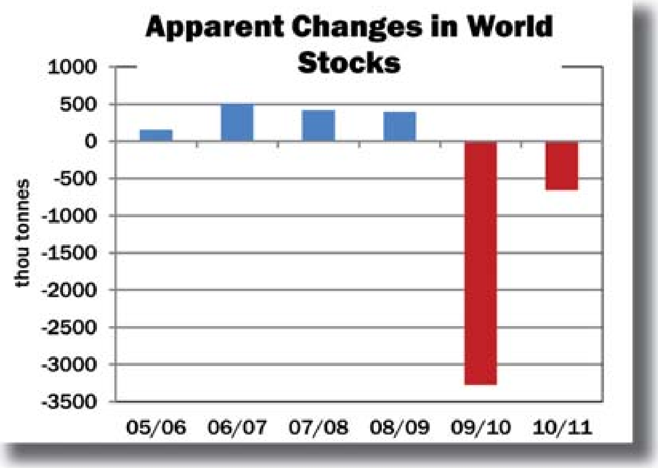


Those mills requiring prompt shipment cotton have had little choice other than to pay the price, turn to an alternative fibre or, indeed, curtail output.

World cotton stocks are in decline for a second successive season, according to Cotlook's estimates, and the degree of reduction may prove to be tempered only by the amount mills cut back on use, something on which the anecdotal evidence is contradictory from market to market and, in some instances, within a single country.

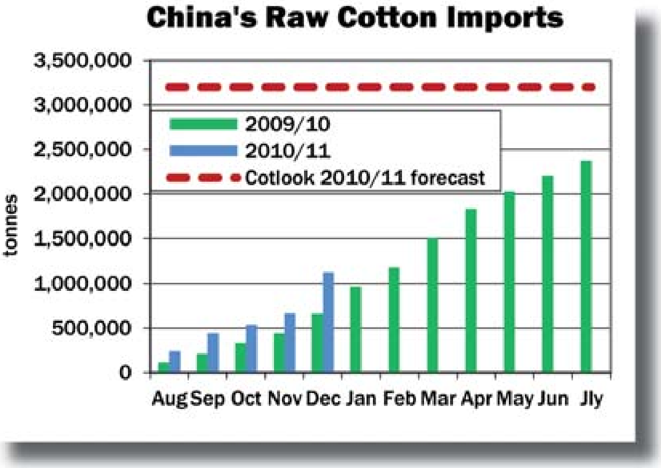
China is a prime example of the latter. Official statistics portray a booming rate of economic growth, strengthening retail sales and high levels of yarn output. Anecdotal comments speak of decreasing profitability as the yuan strengthens against the US dollar, operational cutbacks, especially among small to medium-sized enterprises, and extended holiday closures over the Spring Festival. In consequence,

some estimates of consumption have been pared, leading to reduced expectations of how much cotton will actually be imported during the current international cotton season, i.e. from August last year until the end of July. This is not to say that China's overall import requirement during the current



calendar year will be less, rather that, perhaps, shipments may prove later than at first imagined.

In this context, a novel development this year has been the emergence of substantial forward buying, principally by Chinese trade houses, mainly for December and early 2012 shipment, prior to and following the introduction of the January 2012 delivery contract in Zhengzhou. This commenced trading at a significant premium on the prices at which cotton had been offered by international sellers, at least for import under the 'processing trade' category, (against which duty and VAT are effectively not applicable, provided the resultant manufactured goods are exported). International traders have proved willing to participate in the sales, despite the lack of experience of transacting cotton for such distant periods in China, on the proviso that some kind of upfront, financial surety was forthcoming. The accompanying chart demonstrates

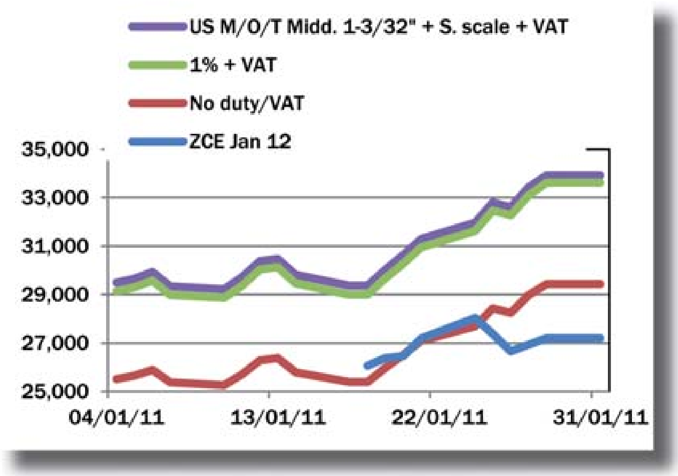


the development, during January, of the relationship between the Zhengzhou forward month and Cotlook's adjusted quotation for US M/O/T 1-3/32", for December/January shipment (as reported in Cotlook's Cottonquotes* service).

** Cotlook Cottonquotes (www.cotlook.com) is a daily service giving the full breakdown of the Cotlook A Index, plus representative offering rates for a range of other cottons and a range of other daily data.*

By January 20, sales to China of over 73,000 running bales accounted for 33 percent of the forward US export sales commitment, versus none by the same point a year earlier. Demand for a similar timeframe and beyond has also been increasingly a feature in several other customary importing markets.

The propensity of mills to buy for such distant shipment periods is testimony to the bullish frame of mind of the market, to the doubts surrounding Northern Hemisphere new crop production prospects and to the wish of buyers to try to ensure a competitively-priced supply against more distant requirements.



Besides US cotton, the origins traded forward have included Australian, African Franc Zone and Brazilian.

Policy changes

2010 and, so far, 2011 have been remarkable in the impact government policy in a single country has had on the world market. India, a relative newcomer as a consistent – until the past year - major supplier to the world market, has witnessed restrictions placed on exports of both raw cotton and cotton yarn. The contention that had begun to develop between US and Indian export sales, with the latter, at times, challenging the former, has therefore been less of a market factor this season than might otherwise have been anticipated.

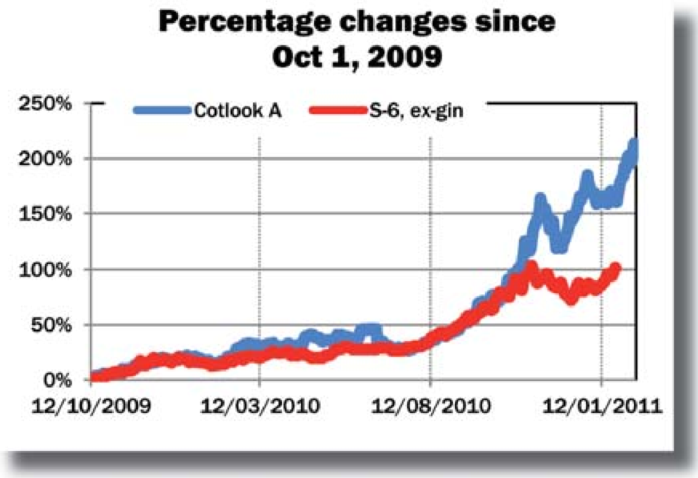
India's policy has been driven by a desire to ensure the competitiveness of the domestic textile industry, provided a detrimental impact on the prices received by cotton farmers could be avoided. Measured by ex-gin selling rates, attainment of the latter goal appears to be unquestionable: values have been far in excess of the equivalent substantially-increased Minimum Support Prices for seed cotton introduced in 2008 and well above – sometimes double - the comparable lint values prevailing last season.

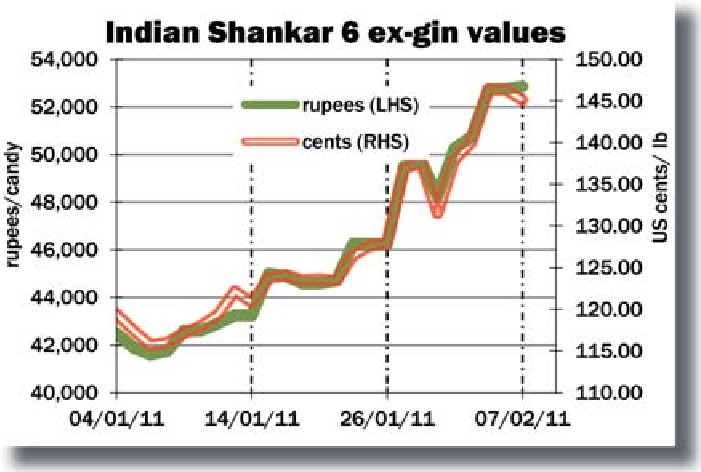
However, in comparison to the increase in world values, the advance in domestic lint costs has been muted. The Cotlook A Index, during the period since October 1, 2009, has risen by over 150 percent (significantly more, on some occasions).

Challenges for the future

By the time this edition has gone to press, some clearer signs should have emerged as to the outlook for this year's cotton plantings in the Northern Hemisphere. Cotton Outlook's first estimates were scheduled for publication in mid-February.

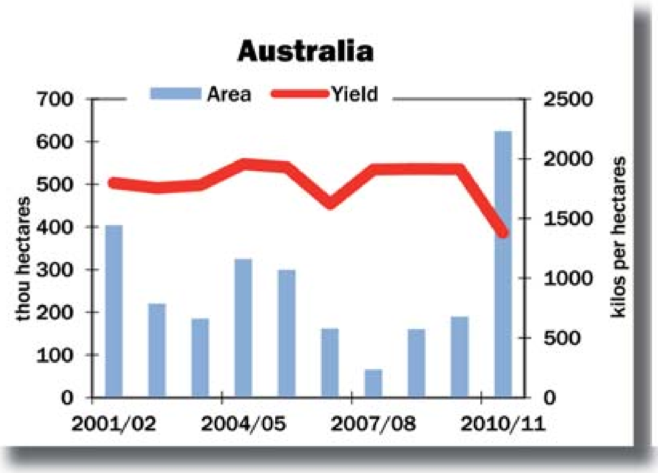
The reaction of farmers in the Southern Hemisphere to the high prices ruling prior to the year's end was undoubtedly to give preference to cotton – a record crop in Australia, for instance, would have been comfortably attained had it not been for the devastating floods, and may well still be

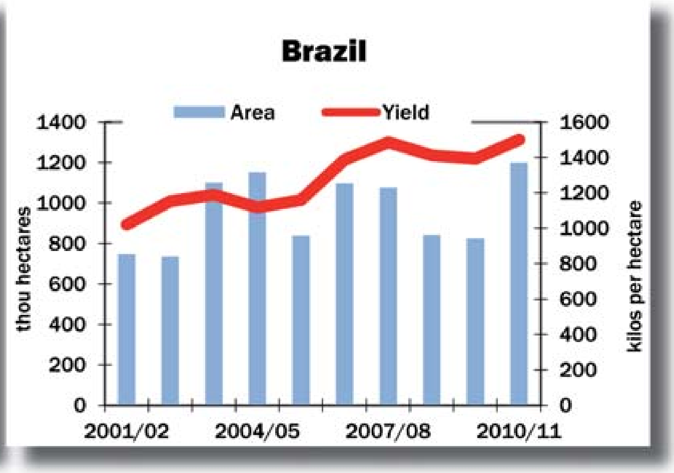


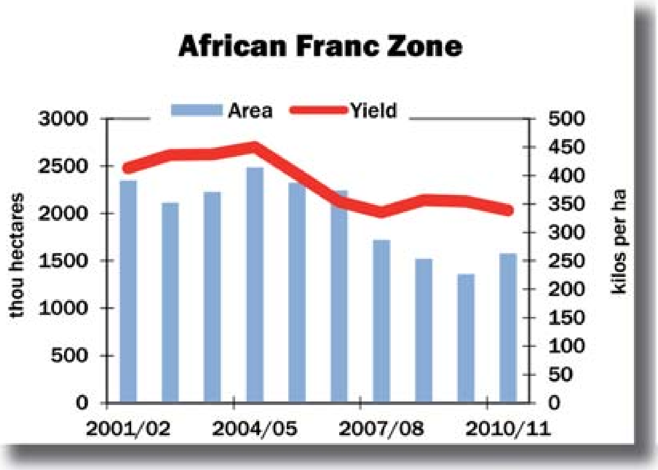


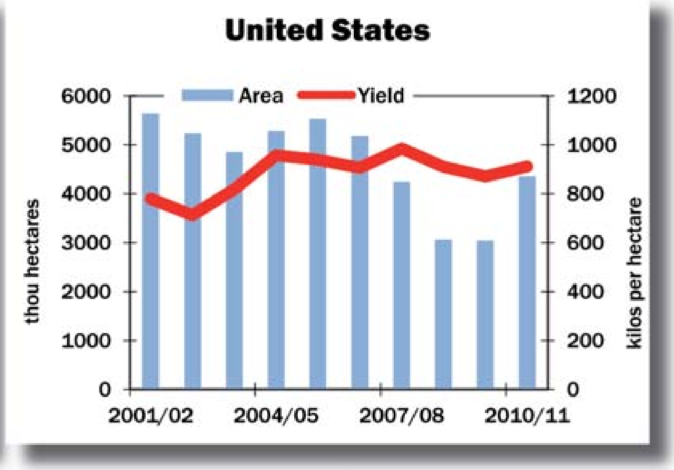
achieved, while Brazil is easily on course to surpass its previous highest level of output. Some Northern Hemisphere producing countries expect, likewise, to see expansion but the overarching consideration for many governments will be to ensure that farmers increase output of food crops, in a world in which pressure on land resources is intensifying, leaving agricultural yields as the principal means of raising production. This is not merely a short-term consideration, but one that will surely assume increasing importance in commodity price relationships and farmers' choice of crops in the years ahead.

In the circumstances, pressure on governments to defend local resources for local users will presumably intensify, whether those resources are food or cash crops, such as cotton. Therefore, a shift back to cotton being exported under open general licence in India seems, on current indications, improbable, Uzbekistan, with little room (or apparent desire) for expansion of sowings, can be expected to consume increasingly more of its own cotton production, Pakistan will be a meagre supplier of the raw material to world markets, even in the best cotton production years, and China, despite being the world's dominant producer, will continue to require massive imports to feed an expanding industry. Among the largest cotton producing countries, therefore, the significance of how much cotton is grown in the United States, the leading exporter, Australia, having a minimal domestic requirement, and Brazil, still with land available for agricultural expansion, will remain undiminished. It remains meanwhile to be seen whether the decline in average yields in the African Franc Zone – another potential source of significant exportable supplies - can be reversed, even partially.









Crop prospects during 2011/12 in the United States will depend vitally on price relationships as planting time draws near; at the time of writing, the forward discounts in futures markets for wheat, soybeans and corn (maize) were smaller than those for cotton. In subsequent years, the shape of revised government policy will doubtless play a key role. Discussion of new farm legislation has yet to make substantive progress in Congress but it might already be assumed that budgetary pressures will prove restrictive, and that environmental concerns will play a more prominent role.

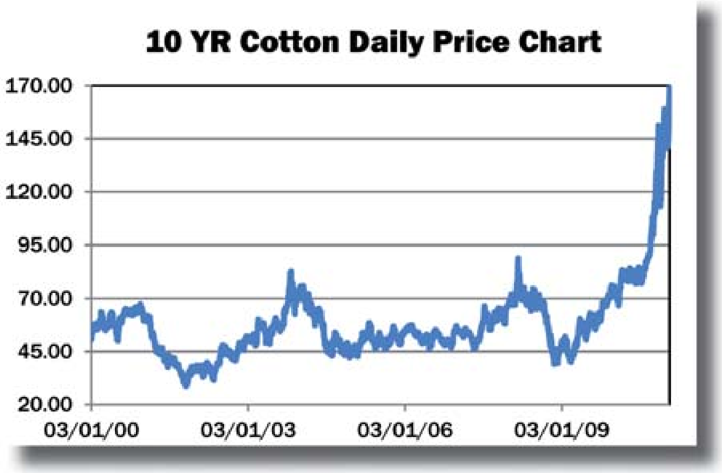
Whatever the eventual scale of global plantings, the main challenge facing buyers and sellers of cotton is undoubtedly coping with the increased price volatility that has characterised the market during the past couple of years. With extended trading hours in ICE futures, and the ready inflow and outflow of speculative money, price risk management has undoubtedly become more difficult for all participants. Protection against contractual deficiencies, or plain defaults, is undoubtedly a vital necessity in today's uncertain and unpredictable market.

Trading in a Volatile Market

By Mr. Antonio Esteve, CEO, Ecom Cotton Group

In the eight year period from 2000 to the end of 2007 the New York Futures spot price traded in a relatively narrow range, closing under 40 US cents/lb just 11% of the time and over 70 cents/lb being an even a rarer phenomenon, at just 3% of the time. A full 86% of the time therefore, New York futures spot prices closed within a 30 cents/lb trading range from 40 to 70 cents!

What has happened since 2008? Price behaviour has changed dramatically, becoming very volatile. In 2008 we saw prices close synthetically near $1.10 in March and below 40 cents in November, or a full 70 cents trading range for the year. In September 2010, prices rose even more significantly when the New York spot quotation surpassed 70 cents, and never looked back. Since October, prices have closed over $1.00 and as I write this article on January 27, 2011, the H1 quotation has surpassed $1.70, all unprecedented for cotton prices. As you read this article, I even wonder what the New York futures spot quotation may be trading at!? For sure, I venture to predict nowhere near $1.70! (See 10 yr Price Chart).

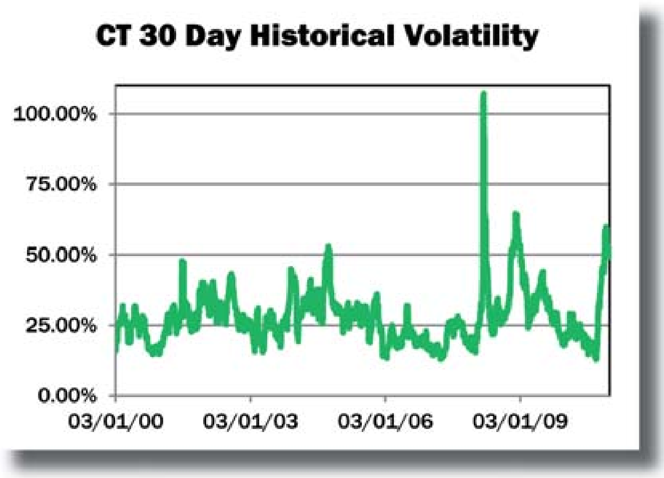


Between 2000 and 2007, 30-day historical volatility averaged 26%, with levels as low as 13% and rarely over 40%, but for brief periods. During the period 2008 to 2010, historical volatility rose to a 33% average with a dramatic peak of over 100% in March 2008. Since October 2010 volatility has risen consistently over 30% and has remained between 50 and 60% through the end of January 2011. (See 30 Day Historical Volatility Chart).

How can we adapt to these high prices and volatile times? The first thing we need to appreciate is that with today's high prices, something like three times more capital is required to run your business. If you are hedged, margin calls become the order of the day and they are not modest amounts. Scrambling for funds becomes a routine. Those not hedged on the other hand, are running tremendous market risks. Without being properly capitalized and having sound financial planning and secured resources, it is near impossible to run a business. A second thought is counterpart exposure. With today's market volatility, just the next day after any transaction, significant market differences may already have come into play. These huge differences in open contracts mean contract sanctity immediately becomes an important consideration. Knowing who you are doing business with and how reliable they may be is of the essence, as your book may be square but your exposure still tremendous. At the ICA for example, we are particularly concerned about the demand we may have for arbitrations. After record numbers of arbitrations in 2008 and 2009, we could still hit a new record in the months ahead if counterparty risk is not properly managed.

Chaos theory teaches us that a butterfly flapping its wings in Brasil may cause a wind

storm in West Texas. The world of cotton is being impacted by so many changing macro-economic phenomena that we can be blindsided by some unforeseen event at the blink of an eye, and simply looking at the cotton Supply & Demand balance sheet is not nearly enough on which to plan your trading and marketing strategies. There are certain events that change everything, even drastically and after the storm, things do settle down but in a new norm, a new world, where who survived, survives, and those who did not are out of the game. It seems to me we are still in the middle of the storm that started with the sub-prime crisis, and it may still take some time to play out before we return to the stability we were used to prior to 2007.



With these highly volatile and unpredictable markets, both the brave and timid be warned. In March 2008 we lived through a dramatic Black Swan event (one that deviates beyond what is normally expected of a situation and that would be extremely difficult to predict) that shook the very foundations of the cotton world. Many merchants were either forced or opted to downsize, while others suffered more drastic consequences going to the extreme of exiting the business. We are no doubt living in a brave new world full of enigmas and surprises and what lies ahead may even be more dramatic than what has passed.

While eagerness and greed may induce some to maximize what seemingly are fantastic trading opportunities during these volatile markets, the recipe for survival may be in fact quite different. India may be a good example as current government interference in cotton exports plays havoc on contract performance. Buying forward from local Indian gins has proven disastrous. Another example are the current, huge 'On Call' New York futures positions, while at the same time the USA is mostly sold out of its cotton supply and certified stocks are minimal. Mills buy On Call to secure their forward supply but remain unfixed, not knowing forward yarn prices; meanwhile they dread being long fixed price cotton at today's historically high price levels, fearing if cotton prices fall they will be left holding expensive cotton. How will this play out? Will New York futures ultimately correlate with yarn prices over the coming weeks and months or will they diverge, exacerbating the price difference between On Call/unfixed and yarn prices? And what will be the consequences for mills and their suppliers? All members of the supply chain must reappraise their business model and adapt their methods to mitigate today's increased risks.

It seems we may have no choice, as long as these crazy markets are with us, other than to throw away our old trading concepts and start with a totally new frame of mind; like thinking of doing lesser volume and trading for bigger margins, trading more nearby and less forward. The reward indeed needs to compensate the huge risks being undertaken. The recipe certainly needs to include reassessing and reducing exposure to New York Futures, and being more selective about the business you do and the counterparties you choose. We need to avoid trading with cannibals, because if we do, guess who's going to be lunch? The name of the game is no doubt: Survive.

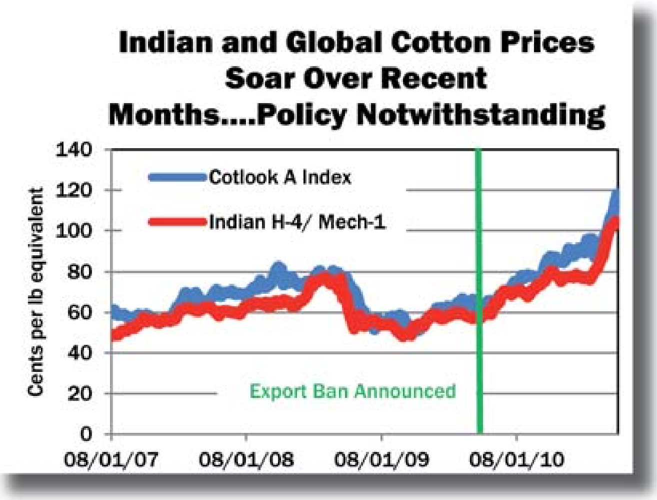
Let Market Forces Prevail

By Mr. Mohit D Shah, Director, Gill & Company Pvt. Ltd. Mumbai, India

Let me begin by saying an already known fact - India is the second largest producer, consumer and exporter of cotton in the world. Rather than going into these numbers it is imperative today to address the influences such a dominant player wields across the cotton globe when there is any form of disruption, which unfortunately is the issue at center stage of the cotton world.

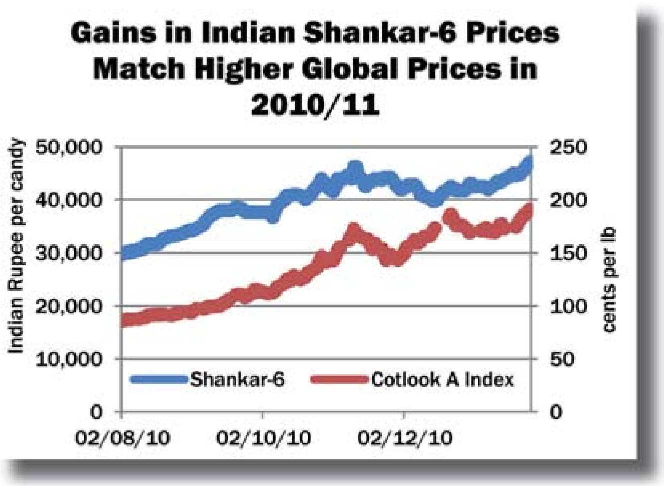
Since 2001, India followed a free trade policy and cotton was exported under open general license. Until recently India was seen as the new, emerging, giant exporter of the fiber after the United States. However, events during the last several months have put this belief to serious questioning.

A string of measures announced by the government has cast a shadow upon local farmers, merchants and exporters, not to mention importing textile mills worldwide. Starting with imposition of export duty and ban on export registrations in April 2010, the government decided in June once again to allow cotton exports, starting October 1st. In September, the government announced plans to commence export registrations in early October, but delaying shipments until a month later, with a mandated 45 days window of shipment performance. Effectively, between November 1st and December 15th, exports were limited to just 5.5 million bales. The number of bales allowed to be exported was probably half the amount India would have otherwise exported in a free export regime. Echoing the sentiments gleaned from numerous views put forward by the global cotton trade, it can be inferred that these arbitrary and ad-hoc policies have had major ramifications both for the sellers and for overseas buyers resulting, in major defaults and disputes, the effects of which have been catastrophic and will reverberate for long.



The government's actions were taken with the intention of ensuring adequate supplies for the domestic textile industry and throttling back climbing prices. While the restrictions prevented exports temporarily, it did not protect the textile sector from the sharp rise in cotton prices, domestically or worldwide. In concert with tightening world stocks, the USDA says the ban helped drive up 'A' Index prices by nearly a third, to a record high by late September, reaching an unprecedented 118.00 cents per pound. Similarly, domestic prices rose, in tandem with soaring global prices, to record levels for most dominant varieties in the country. Despite its best intention to contain domestic prices the government's interference in the open market cotton trade backfired.

Today, overseas buyers have compromised to a great extent and swallowed their mercantile pride due to the tight cotton supply situation. Once the world rebuilds stocks, which will happen at some stage, it will be very difficult to sell Indian cotton. In future, buyers will be extremely wary of buying Indian cotton for their consumption; Indian cotton will erode its true value, as buyers will price in all of the risks experienced this year, thereby leading to Indian cotton being heavily discounted against other comparable growths.



The reputation of India as a reliable source has been seriously damaged and the efforts made so painstakingly over the years to establish Indian cotton in world markets have been categorically nullified.

Looking inward, there are equally large challenges that the cotton trade faces today. Market turbulence and huge price movements inevitably strain any system. In face of record high prices, Indian exporters holding valid bargains were faced with mass defaults on their forward contracts from ginners, and incurred huge losses as they honored their commitments to buyers at the destination. It is undoubtedly very satisfying for one party to benefit from an advantageous market situation but eventually the pendulum will swing. Business through a handshake will give way, in future, to iron-clad contracts. The implications of a breakdown in the mechanism of forward contracting, and the consequences, therefore, of being forced to rely purely on a spot market, would be disastrous for suppliers and consumers alike; forward business in India will suffer a complete collapse.

The urgent need of the hour is to develop a vibrant cotton futures market for buyers and sellers to use as a hedge, to demonstrate a quick and effective arbitration system and bring guard against those who have shown that they are not prepared to abide by the rules when the situation does not suit them, and introduce a default list of non-performers.

With globalization it is difficult to manage or manipulate domestic prices. In a buoyant global economy in which fiber demand is rising every year at a faster clip, we need to see the government, textile industry and trade work together with a common agenda and a clear focus on increasing yields through technology and integrated farm management models. Such an approach would enable India to meet the long term requirements of both the domestic and the world's cotton textile industries. Coordinated and well-directed efforts are required to raise cotton production and simultaneously increase income levels of millions of cotton growers and thereby support sustained growth in the cotton economy.

Fortunately, India today has the largest area under cotton in the world and this is a great strength. Patterns show that, whenever cotton prices have been high, cotton growers have usually increased the area and continuing this momentum today is critical. The Indian farmer has to be encouraged to plant cotton like never before, especially in face of stiff competition from other competing cash crops. Record high prices for those crops, could in fact result in area being taken away from cotton.

In conclusion:

Although production is poised to grow, year-on-year, consistent and market friendly trade policies will be critical to ensure India's dominant position the world cotton market.

The price of cotton should be determined by market forces and not through artificial measures. A cotton farmer must be able to receive the best price for his produce by selling it either to a local or an international textile mill.

The trade in international markets must proceed uninhibited by actions of governments. Contracts executed between a willing buyer and a willing seller must be honored if confidence in trading is to be secured and enhanced.

Unless we are able to send a clear signal to the world through clear policies, free from 'flip-flops', the future is filled with great unknowns.


Memphis
Liverpool

Limitation of Liability – Protecting Your Cotton contract

By Miss Helen Anderson, Outlook Consulting Limited

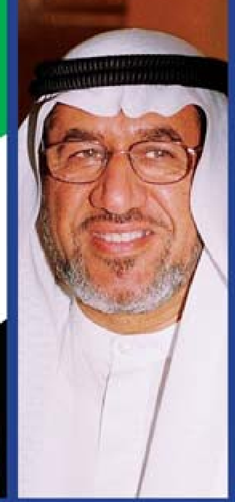
Parties to contracts of sale under English Law are entitled to agree to limit, or reduce, their liability to pay financial compensation to the other party, if they cause a breach of contract. Such clauses, to be valid, must satisfy the test of being incorporated into the contract, clear and, most importantly, unambiguous.

As most readers will know, under International Cotton Association (ICA) Rules, the default position in cases of non-performance of contract is invoicing back at market value at the date of closure, in accordance with Rules 225 and 226. Although this principle cannot be overruled, it is possible for parties to agree a limitation clause that specifically states an agreement to invoice back at par, or by reference to an alternative agreed specific formula, in defined circumstances. A purported general, non-specific exclusion of liability will not make any impact upon the usual application of invoicing back.

It should be emphasised that invoicing back under ICA Bylaws and Rules is essentially an accounting device that is designed to prevent a party gaining a fortuitous profit through the impact of unexpected market movements. As the typical international cotton sales contract is based on shipment/sale of documents of title (FOB/Cand F terms etc), and not on the physical delivery of goods, a general 'limitation of liability' clause as to the effect of a party's inability to physically deliver cotton (for whatever reason) is very unlikely to impact the usual application of invoicing back at market value, as an accounting mechanism.

The issue of limitation of liability clauses, specifically as they relate to the invoicing back procedure, in recent months has remained in the limelight in specific cotton markets, including India. In that country, for example, alterations to export registration regulations and requirements have led to renewed anxiety regarding contract protection for Sellers in particular, and also concern as to the granting of necessary permissions, at least in sufficient volume, to fulfil commitments. This concern likewise has prompted particular attention to the detail of wording of limitation of liability clauses.

In particular at times of unusual market restriction, or dramatic and unexpected price movement, it should be remembered that both Buyers and Sellers have equal rights and responsibilities under a cotton sale contract. It is prudent for both to consider how best to protect themselves in case physical performance of a contract becomes difficult and agree contract clausing accordingly.



Importance of cotton for member countries of the OIC

By Dr. Waleed A. Al-Wohaib, CEO, International Islamic Trade Finance Corporation

Cotton, widely known as the "white gold", is grown worldwide in more than 80 countries with 22 out of the 57 member countries of the Organisation of the Islamic Conference (OIC) cultivating cotton. As such, among the top 40 cotton-producing countries in the world, 21 were OIC members with Pakistan ranked 4th, Uzbekistan at the 6th position, Turkey and Turkmenistan came 8th and 9th respectively. With about 30% of the world's cotton area and 28% of world cotton production originating from member countries, the dominant position of the cotton sector is so strong that success or failure of the cotton crop in a single year may adversely affect economic growth and development. As a group, the OIC countries are considered as the second largest exporter of cotton in the world after the USA, whilst Sub-Saharan Africa is the world's third largest exporter, behind the USA. Benin, Burkina Faso, Chad and Mali, collectively known as the Cotton Four (C-4), are the major cotton-exporting member countries in the West African sub region. In West and Central Africa, millions of people are involved in cotton production and earn their livelihood from the crop.

Cotton for sustainable socio-economic development

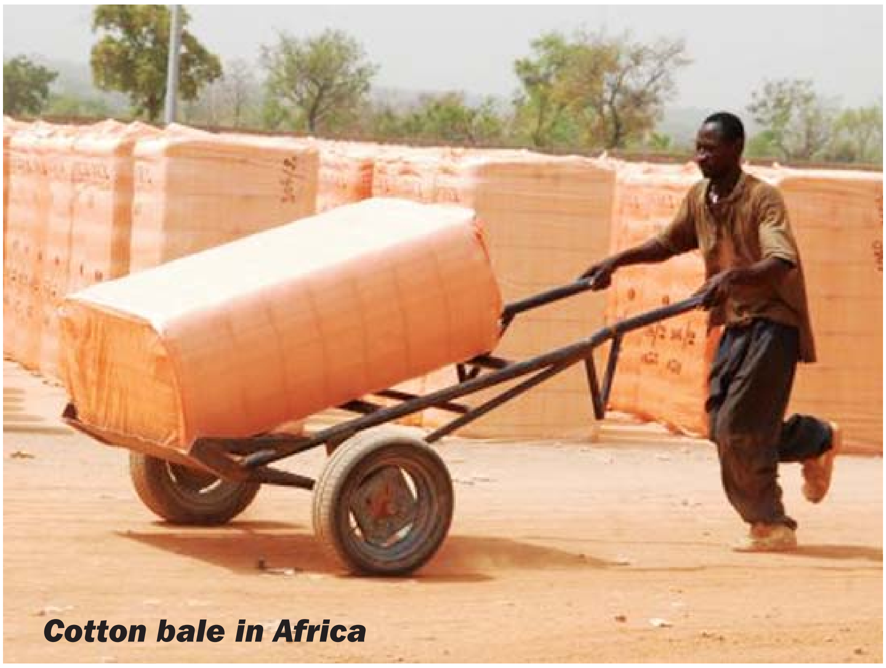
As an important cash crop, cotton is playing a pivotal role in the socio-economic development of a significant number of OIC member countries, equally at farm and national level. For many of the OIC Least Developed Member Countries (LDMCs) in Sub-Saharan Africa, exports of this primary commodity strongly impact the prospects for growth and development in the form of rural well-being, contribution to GDP, food security and the like.

Similarly, as an agricultural export commodity, cotton represents the mainstay of foreign exchange earnings and a major revenue source. For instance, in the C-4 countries, cotton accounts for between 5 and 10 percent of GDP, exports of cotton fibre contribute over one-third of all export income and more than 60 percent of income from agricultural exports, and involve over 30% of the total population. Thus, cash income earned from cotton production allows farmer households, especially those in arid and semi-arid areas where food crops are difficult to produce, to pay for food, health care, education and other necessities that would not otherwise be available. Moreover, cotton is a major source of rural employment, especially during the weeding and harvesting seasons. This in turn accelerates economic and social development, thus alleviating poverty and improving peoples' lives.

Cotton and Food Security

Income and foreign exchange generated through cotton cultivation is the primary reason to extend credit for agricultural inputs in the form of fertilizer, pesticides, urea, etc. Growing cotton goes hand-in-hand with the ability to grow food, hence placing cotton as a major contributor to food security. Based on this, it is evidenced that "there is no hunger in areas where there is cotton". Cotton thus plays a leading role in food security through revenue generated to finance inputs, enhance soil fertility and delay the development of pests and diseases in properly-managed crop rotation systems involving cotton and other crops. Undeniably, access to quality inputs, credit, appropriate technologies and assured markets are amongst the major critical success factors for food security, particularly in Africa.

For the above-mentioned reasons, the cotton sector has been at the forefront of the Islamic Development Bank (IDB) Group's agenda in its bid to alleviate poverty.



Cotton bale in Africa

early stages of production. ITFC has thus developed a tailored solution namely 'Supply Chain Structured Commodity Trade Financing' to tackle complexities in the agro-industry, notably in the cotton sector. The primary objective of the Structured Trade Financing (STF) is to use an effective collateral management system as well as export/future flow of funds to mitigate perceived high risks such as sovereign, convertibility and transfer risks. Given its innovative structure, STF contributes to the repair of the agricultural production cycle, disturbed by the recent financial crisis, particularly in Least Developed Member Countries.

Structured Trade Finance solution: Creating value for impact

Similarly, the experience of the International Islamic Trade Finance Corporation (ITFC) shows that creating impact for people involved in the cotton cycle requires the intervention of financial institutions at the early stages of production.

In addition to contributing to the social welfare of millions of farmers, ITFC has played a catalytic role in mitigating the risk factors to encourage trade, building investment confidence in least developed markets and enhancing member countries' export capabilities.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IDB/ITFC's intervention in the cotton sector

A number of initiatives have been undertaken by the IDB Group to develop the cotton sector and enhance cooperation between member countries in the area of cotton production and trade. The "OIC Five Year Cotton Action Plan (2007-2011)", aimed at increasing the efficiency and effectiveness of the cotton sector, identified five priority areas for implementation, namely enhancing productivity and production techniques, strengthening structural capacities and organisations, developing processing and marketing, as well as improving competitiveness and financing.

The IDB Group's intervention in the cotton sector dates back to 2004, following several years characterised by successive hardships for West African cotton producers (those in the Fcfa zone), who suffered from low output prices, below US$0.5 per lb (US$1.12 per kg), or 47 percent lower than the previous year's level. The bank's Trade Finance and Promotion Department (TFPD) approved the first operation in Mali, amounting to $61 million for the financing of inputs for cotton.

ITFC's interventions in the cotton sector have also been numerous in terms of the provision of funds for production and trade, to complement member countries' financing requirements and through a number of activities implemented under its Trade Cooperation and Promotion Programme (TCPP). The latter focused on supporting matters relating to the development of strategic commodities with a view to

expedite the action plan in value-added commodities in general, and cotton development in particular. For instance a workshop on Trade and investment in the cotton sector in OIC member states was organised in Cairo on 12th/13th October 2009.

Furthermore, cotton has been one of the key strategic commodities that the ITFC has supported since its launch more than three years ago, starting from pre-harvest financing - by providing inputs for cotton production - and moving downstream, in the entire cycle, from ginning up to pre-export financing, thus addressing and fulfilling the basic needs of the cotton players. By providing post-harvest financing for purchases of seed cotton, ITFC assumed responsibility over the full supply chain, thus contributing to the well-being of millions of people. This move to cover the full cycle transformed ITFC financing to a "Commodity Value Chain Financing", which goes beyond the concept of "Supply Chain Financing". It meant that ITFC has created "value" from seeds to seed cotton, followed by processing into cotton fibre to be ultimately exported.

Besides, as an Islamic finance institution, ITFC monitors all procurements and disburses funds for the purchase of agricultural inputs, or seed cotton, so as to avoid careless use of funds for consumption items. Finance is extended based on the assurance of export contracts, collateral custody in the form of warehouse receipts, and assignment of export proceedings to a dedicated collection account.

ITFC Trade approvals for the cotton sector

Year	Country	Commodity	Amount in million US$
2008	Burkina Faso	Agricultural input & post harvest	102.72
	Côte d'Ivoire	Fertilizers & agricultural input	27.39
	Tajikistan	Import of fertilizers	14
	Sudan	Fertilizers & pesticide	25
2009	Turkey	Cotton & Oil seeds	20
2010	Burkina Faso	Fertilizers & Agricultural input	56.1
	Cameroon	Fertilizers & agricultural input	17
	Sudan	Fertilizers and sackcloth	26.1
Total			288.31

Since its inception, ITFC has approved trade operations for an aggregate amount of US$288 million as shown in the table below. In 2008, the total trade financing extended by the ITFC to the cotton industry stood at US$169 million in several member countries, primarily in the form of input financing for the purchase of fertilizer and pesticides. In 2010, ITFC approved trade finance operations for the cotton sector amounting to US$99 million in the African region.

ITFC Award for a cotton structured trade finance operation

In 2008, the ITFC was awarded the prestigious Trade Finance "2008 Deal of the Year Award" from Euromoney. The award crowned the ITFC's first year of operations with international recognition that exemplifies the purpose of ITFC, which is to enhance the economic welfare of its member countries through trade.

ITFC carried out a €23 million Structured Murabaha* Operation for Côte d'Ivoire's strategic cotton sector that was of great social and economic importance. This Shariah-compliant operation was one of the unique operations that linked the application of Islamic financial instruments with a close risk management system pertaining to the entire cotton farming cycle. The facility was provided to the state Compagnie Ivoirienne pour le Développement des Textiles (CIDT) for the purchase of agricultural inputs to be distributed to local farmers on credit, whereby ITFC is reimbursed through the sales proceeds from the cotton ultimately exported by the borrowers.

This deal was also considered a landmark achievement, as it helped revive the Ivoirian cotton sector, in addition to demonstrating a number of significant innovations compared to standard pre-export finance. Moreover, it helped stabilise the sector and set in motion new growth opportunities for cotton farming, which covers 60% of the total cultivated land in Côte d'Ivoire and provides livelihoods directly and indirectly to 3.5 million people.

About ITFC

The International Islamic Trade Finance Corporation (ITFC), a member of the Islamic Development Bank (IDB) Group, is advancing trade to improve the economic situation and livelihoods of people across the Islamic world. A rich heritage spanning more than 30 years in trade finance by the IDB Group, puts the ITFC in a leadership position to help foster socio-economic development through trade, support the development of strategic commodities that underpin a nation's economic welfare and provide sustenance and livelihoods to a significant proportion of the population.

Moreover, the ITFC's mission is to be a catalyst for the development of trade among OIC member countries and with the rest of the world. With a vision to be a recognized provider of trade solutions for the OIC member countries' needs, the ITFC is operating to world-class standards, promoting the IDB Group's developmental objectives in order to fulfil its brand promise of 'Advancing Trade & Improving Lives.'

For more information please visit:
www.itfc-idb.org

*Murabaha (cost plus sale) – an Islamic Financing Structure where a financial intermediary -in this case ITFC- purchases goods or commodities directly from the supplier at a cost which is explicitly expressed. ITFC then sells the goods to the beneficiary adding a reasonable margin of profit or mark-up to the purchase price. Murabaha is not an interest-bearing financing mechanism.

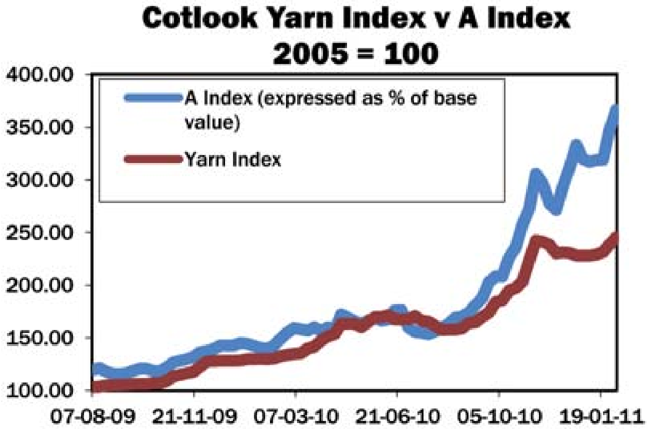
Cotton Yarn Prices

By Cotlook's Editorial Staff

The upward pressure from raw cotton replacement costs has driven prices for cotton yarn to new heights, and has facilitated significant profitability for mills, at times, during recent months.

The accompanying chart compares changes in the Cotlook A Index and the Cotlook Yarn Index against a base point (2005). It does not purport to demonstrate profitability at any single moment, since no account is taken of the timing of mill cotton purchases. However, it does show that, by the beginning of November last year, both cotton and yarn prices had effectively doubled, compared with their levels a year earlier, since when cotton prices have, with occasional corrections, maintained an upward trend, whereas cotton yarn prices, by comparison, have tended to stagnate.

At the time of writing (late January), some reports suggested that cotton yarn values had once again assumed an upward trajectory, under the influence of higher raw cotton replacement costs.



In addition to the influence drawn from the raw cotton price advance, the earlier incline of cotton yarn prices was, to some extent, driven partly by India's decision (like that for cotton) to place restrictions on the quantity that can be exported (though in reference to a time period ending on March 31 this year).

In recent times, the phrase 'demand destruction' has been used to describe the impact of the divergence of prices for cotton and yarn, and has brought into question forecasts of this season's prospective world cotton consumption. However, investigation into this issue has brought mixed responses: some switching of fibres has doubtless occurred in some markets, and some mill operations have been impeded for want of raw material supplies; the evidence of consumption decline on a scale that might significantly alter the world supply and demand statistics, by bringing the current season's production and consumption closer into balance, has, nevertheless, so far lacked conviction.

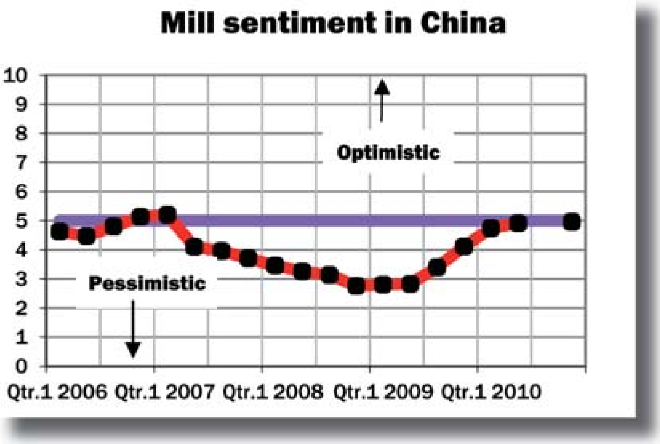
Looking ahead, the principal uncertainty surrounds the action of western retailers in booking their next lines, both in terms of the fibre content specifications and, in a broader sense, the size of orders placed, given the economic pressures on EU and US consumers. In the latter context, it is interesting to note anecdotal reports from industries in countries such as Turkey and Egypt, referring to a return of orders that had previously been lost to China from EU buyers, on grounds of proximity of supply and the flexibility to meet 'just-in-time' criteria.

Cotlook Business Confidence Survey

Cotton Outlook conducts regular quarterly surveys of mill business confidence in a number of major consuming markets. The next such survey will be under way as the Dubai meeting with which this Special Feature is associated, and will be published in

the Cotton Outlook weekly magazine* at the beginning of April. For the benefit of readers, the results of our survey published in January are summarised below.

Of the 56 Chinese mills that participated in the survey conducted on our behalf by Beijing Cotton Outlook, very few indicated that they had added to capacity during the last quarter of 2010. The average view of business prospects, on our scale of 1 to 9, remained at just under 5 (neutral), little altered from the responses gathered some six months earlier.



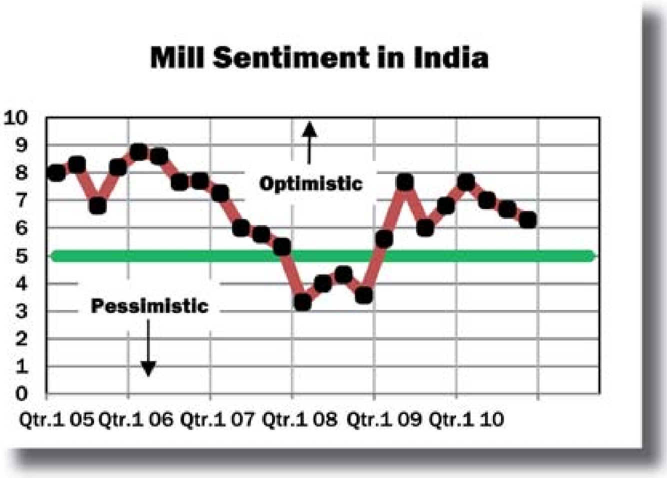
However, more caution was expressed, prompted by a downturn in demand from weavers and knitters. Tightening credit lines, under the government's anti-inflation drive, and the expected appreciation of the yuan against the US dollar were casting a shadow over prospects for the remainder of this year.

Mill sentiment in India dipped, on average, to 6.29, against 6.67 back at the end of September 2010, though many respondents had either recently invested or indicated an intention to expand their capacity during the initial part of 2011. All respondents expected raw cotton consumption to rise in 2011/12.

Pakistan saw an improvement in business confidence towards the end of last year, to an average of 6.125, compared with 5.6 at the end of the third quarter. However, investment plans appeared to have declined. Estimates of this season's domestic cotton consumption ranged from 13.5 to 14.5 million bales (local weight) and all participants anticipate a rise next season to above 15.0 million.

South Korean mills were the most upbeat within the South Asian region. Expansion in spinning capacity of 10 percent is forecast during 2011.

* Cotton Outlook is published in 51 issues, both in print and electronic versions.



Vietnam's spinning sector is continuing to grow and consumption of raw cotton and polyester was forecast to increase. Some financially strong operations in Indonesia indicated they were also adding to capacity, though a shift toward man-made fibres was mentioned. Thai spinners were cautiously optimistic. Improved yarn sales last year had bolstered sentiment in Malaysia. Taiwan expressed a more neutral view.

Many mills in the United States appeared to be running at full capacity, confidence was relatively high and fibre consumption was said to be increasing. In contrast, some mills in Argentina expressed the intention to reduce raw cotton consumption.

Turkish mills appeared optimistic about the yarn business climate and some had invested in new capacity towards the end of 2010.

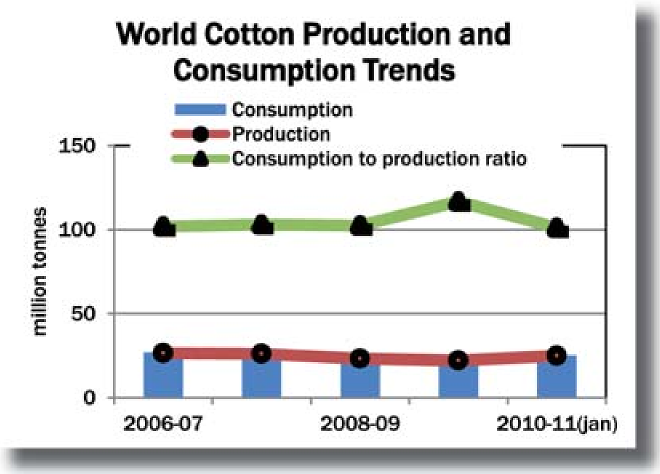
A decline in capacity was mentioned in Greece, whereas a possible increase in spindleage was referred to in Germany.

World Cotton Process: An Indian perspective

By Mr. I. J. Dhuria, Head, Raw Materials Sourcing (Textiles), Vardhman Group, Ludhiana

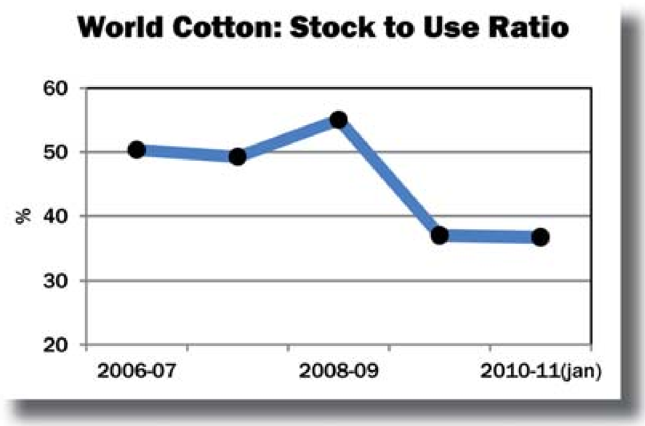
After steady trends during 2006-07 to 2008-09, world cotton prices have recently shown a high degree of volatility, which in part can be attributed to the fundamental demand and supply gap factor, and partly can be associated with contemporary developments in the major cotton producing and consuming countries in the world, especially in Asia. The Asian region has seen growth of textile manufacturing in the last two years, especially in China and India.

Considering the demand/supply gap factor first, the trend of the last five years in the world consumption to production ratios reveals that both grew in tandem until 2009-10, when world cotton consumption increased to 25.8 million tons, against cotton production of 22.1 million, and the consumption to production ratio increased to 117%. In the ensuing year, the ratio came down to almost 100%. In the three years ended 2009-10 i.e. during 2006-07 to 2008-09, the consumption to production ratio remained in a narrow range of 102% to 103.5%. Thus, the disturbance caused in the world demand/supply relationship brought upward pressure on cotton prices.



Further, the stress on supply situation was exacerbated by the reduction in the stocks-to-use ratio. The world cotton balance sheet shows that the ratio declined from as high as 50.3% in 2006-07 to 37% in 2009-10 and remained low in 2010-11. Thus, prices of cotton fibre disconnected from the past trend and shifted abruptly upwards.

In addition to the above factors, the growth of fiber consumption in Asia - the highest cotton consuming region in the world - also led to reduction in the availability of surplus cotton originating for export in Asia and resulted in increases in cotton prices across the region. This assertion can be corroborated by the fact that the stocks-to-use ratio in China declined from 41% in 2006-07 to 30.5% in 2009-10 (after growing to 50.7% in 2008-09). India was another country in Asia where developments also led to stress on the supply of cotton for trading purposes; consistent increases have occurred in cotton fiber consumption, in sync with the growing capacity of mills for processing cotton. As a result, cotton consumption in India grew from 3.9 million tons in 2006-07 to 4.6 million in 2010-11. Cotton production also grew during the same period, from 4.7 million tons, to 5.7 million. Nevertheless, world cotton prices increased to unprecedented heights.

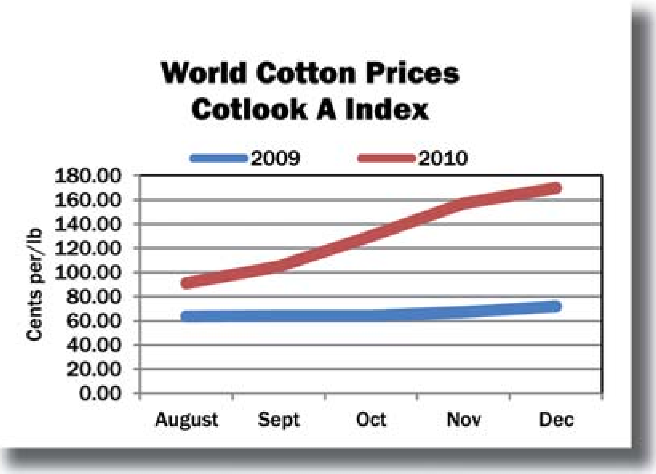


Another factor contributing to the rise in the prices of cotton fibre has been the increased cost of production in Asia, especially in India, which has seen a very high level of inflation in the last couple of months. It is also important to note that rising income levels in China and India have boosted domestic demand for textiles and clothing in the post-2008 recession period.

India: Cotton Balance sheet
(in '000s bales of 170kg each)

	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
	CAB					
Opening Stock	7,200	5,200	4,750	3,550	7,150	4,050
(as on 1st Oct)						
Production	24,100	28,000	31,500	29,000	29,500	32,900
Imports	500	550	650	1,000	700	500
Total Supply	31,800	33,750	36,900	33,550	37,350	37,450
C/Ption by Mills	18,000	20,000	20,300	19,000	20,700	23,050
C/Ption by Non-Mills	1,900	2,000	1,500	1,900	2,000	2,000
C/Ption by Small Units	2,000	1,500	2,300	2,000	2,300	2,450
Exports	4,700	5,500	8,500	3,500	8,300	5,500
Consumption						
Total Off-Take	26,600	29,000	32,600	26,400	33,300	33,000
Closing Balance	5,200	4,750	4,300	7,150	4,050	4,450

CAB= Cotton Advisory Board



Although world production and consumption grew at almost similar rates, except in 2009-10, the increased consumption in China, met by imports, has resulted in expanded volumes of cotton trade. China imported 1.5 million tons in 2008-09 and 2.36 million in 2009-10, and the prediction is that the quantity might exceed 3.0 million in 2010-11.

In addition to supply and demand issues, trade policy in South Asian countries, especially India, has also brought increased uncertainty regarding the availability of surplus cotton for export purposes. The Government of India fixed a maximum limit of 5.5 million bales on exports. Rising prices of cotton led to high cotton yarn prices for the downstream industry in India, which demanded, in consequence, a cap too on cotton yarn exports. The last-mentioned measure has had the result of restricting the export availability of cotton yarn. The unpredictably of such announcements has added to uncertainty, especially in regard to world cotton prices.

The issue now is how Indian mills are responding to the present situation to mitigate the risk associated with rising cotton prices. Industry experts have expressed the view that the cotton requirements of Indian mills are not sufficiently well covered, while domestic prices are rising in tandem with global prices. In addition to the tight availability, the risk associated with the high cost of carrying inventory and uncertain future prices remains uncovered, in the absence of any instrument available for this purpose in India. Furthermore, textile mills in general could face a liquidity crunch in order to finance such huge buying cotton activities. The financial soundness of many firms may be tested in 2011-12.

Pakistan Textile Industry
Performance and Prospects
Importance of Textile Industry in Pakistan

By Mr. Gohar Ejaz, Chairman, APTMA

Pakistan's textile industry is the mainstay of its economy. The industry contributes about 46% to the manufacturing sectors total output, 9% to GDP, over 50% to total merchandise export receipts and provides direct employment to approximately 3.5 million people, which accounts for 38% of the manufacturing sector's total employment. The contribution of the textile industry to the national economy has an added experience in view of its substantive backward linkages to the agriculture sector.

Investments in textile industry

Textile industry in Pakistan invested heavily in the past years to modernize its textile base. US$ 7.5 billion have been invested in the industry since 1999. Of that amount, 50 percent went to the spinning sub-sector, 15 percent to weaving and 17 percent to processing.

Investment by Sectors

	Sub-Sector	Million US $	%
1	Spinning	3,765	50.20%
2	Processing	1,275	17.00%
3	Weaving	1,125	15.00%
4	Knitwear	527	7.02%
5	Made ups	353	4.71%
6	Synthetic Textile	432	5.76%
Total		7,500	100.00%

However, increases in interest rates, energy shortages, higher costs of doing business and Bangladesh market access and trade concessions under FTA's have adversely affected the growth of Pakistan's textile industry.

Performance of the industry this year

The performance of the textile industry in Pakistan has shown positive results in the recent period in terms of increased profits and higher export earnings.

The financial results of listed companies in the textile sector showed significant increase in term of profits, earnings per share and sales volumes in the first quarter of the fiscal year 2010-11 (July-September) over the corresponding period a year earlier. This was due to better product prices offered internationally and in local markets, a profitable product mix, and increase in sales volumes led by a rise in cotton and yarn prices.

Textile exports have increased by 23% to US$ 5.12 billion during six months of the current fiscal year.

The industry has the potential to increase its exports to the record level of US$14 billion by the end of current financial year, mainly due to higher unit values.

Challenges the industry has confronted

The worst ever floods in Pakistan hit hard the cotton production and infrastructural facilities. The United Nations termed the floods as the worst calamity since the 2004 tsunami and October, 2005 earthquakes.

Due to short supply of commodities, prices of all inputs have risen many-fold. Cotton prices in the country have reached a record level of $ 3.4 per Kg.

Imposition of a 15 percent Regulatory Duty on the export of yarn was a short-term measure which was immediately removed following the expressions of concern by the spinning industry. The government of Pakistan has now assured the textile industry that they are the believers of an open, deregulated and market-driven economy and will not distort the free flow of goods.

Opportunities for growth

Textile production will continue to grow in the developing countries since the developed countries are focusing on more technology-oriented and value-added sectors.

Pakistan has signed Free Trade Agreements (FTA) with Malaysia, Sri Lanka, and China, and Preferential Trade Agreement (PTA) with Iran. Talks are under way for FTAs with Bangladesh, Indonesia, UAE, Morocco, and other countries. Officials are now discussing the prospects of FTAs with EU and USA.

Structure of Pakistan's Textile Industry

Sub-Sector	No. of Units	Size (installed capacity)	Production
1. Ginning	1,228	5,488 Saws	More than 10 Million Bales
2. Spinning	521	11.8 million spindles	
		204,000 rotors	2.8 Million tons Yarn
3. Weaving			
a) Composite Units	50	25,000-27,000 shuttleless looms	
b) Independent mills	140	300,000 conventional looms	9020 M. Sq. meters
c) Power loom sector		6,000 Air jet Looms	(Approx.)
4. Finishing			
a) Organized Sector	120		4,600 M. Sq. meters
b) Small Scale Sector	680		
5. Garments	5,000	450,000 Sewing Machines	650 M. Pcs.
6. Terry Towels	400	7,600 looms	55 M. Kgs.
7. Canvas	100	2,000 looms	35 M. Kgs.
8. Knitwear	700	21,000 Knitting machines	6.50 M. Pcs.

A bill for the establishment of Reconstruction Opportunity Zones is passing through the legislative process in the USA. The bill offers 15 years duty-free market access for exports from Pakistan to the USA. Pakistan possesses proximity to the major emerging markets of China and India, enjoys a domestic market of 160 million people, a land route to Central Asia, Afghanistan and Turkey. Opportunities are foreseen for expansion of bilateral trade with China ($5b to $15b), investment of $6.00 billion on a National Trade Corridor for internal transport competitiveness and 'GSP plus' access to the EU.

Structure of Pakistan's textile industry

The textile industry in Pakistan possesses most modern spinning, weaving, and lately finishing and processing technologies. There are more than 1,221 cotton ginning factories, providing cotton to 521 spinning plants with a capacity of 12 million spindles and more than 200,000 rotors. The weaving sub-sector has 24,000 shuttle-less looms, 6,000 air-jet and 300,000 conventional. This gives Pakistan a strong standing in basic textiles. The down-stream industries of dyeing, printing, finishing, and garment-making are also not far behind: about 5,000 garment manufacturing units are producing 650 million pieces annually; production of terry towel is approximately 53 million kilos, canvas 32 million and knitwear 400 million pieces.

Pakistan's textile industry is facing structural imbalances between the sub-sectors. Potential exists to diversify in all sectors from spinning to garmenting.

Cotton

Cotton remains a primary raw material for the textile industry. Massive investments during the past decade have increased the cotton requirement of the country to 16 million bales per annum. For the past several years, Pakistan has been importing more than 3 million bales of cotton annually from different countries to supplement the domestic supply.

Cotton Production, Imports and Exports

Million bales of 170 kg

Year	Production	Imports	Export
2004-05	14.265	2.249	0.704
2005-06	13.019	2.068	0.352
2006-07	12.856	2.987	0.278
2007-08	11.655	5.220	0.278
2008-09	11.819	2.884	0.465
2009-10	12.693	2.03	0.933
2010-11*	10.760	0.61	0.248

** As of 31 December, 2010*
Source: PCGA, FBS

Cotton Production Initiatives

The Ministry of Food and Agriculture has signed a Memorandum of Understanding with an American agriculture seed firm, Monsanto, for the transfer of Bt. technology to Pakistan to facilitate the production of disease-resistant cottonseed.

By adopting the Bt. seed technology, annual cotton production in the country is expected to expand, by 2014, up to 20 million bales from the current level of 11 million bales.

Cotton Imports from India

Pakistan imports 1.0 to 1.5 million bales of cotton every year from India, valued at more than US$ 350 million. The quantitative restrictions placed on exports of cotton by the Government of India have resulted in the cancellation of contracts with Pakistan buyers, despite advance Letters of Credit. APTMA is taking all possible measures to amicably resolve cotton import issues with India.

ICA trading rules

Pakistan is one of the leading cotton importing country. Problems relating to cotton imports are becoming complicated, while importers are not fully aware of the rules of ICA and their rights. Some of the issues and concerns are

- Spinners in importing countries perceive the cotton contract and arbitration proceedings presently being followed being biased towards cotton merchants and against the interest of importing mills

- Slow settlement process at the cost of the importer Short-weight or quantity problems of the first shipment lead to delay in opening LC for subsequent shipments, which leads to carrying charges. This has to be handled within ICA rules or through arbitration

- Absence of standard mode of testing, the mode of quality testing has to be mutually agreed and specified in the contract

- The list of buyers in default should be amended to exclude defaulting members since 2002

- ICA should provide a list of defaulting sellers to be circulated to the importers

- Bring Arbitration under importing country's laws. Branches of the ICA should be established in importing countries to reduce the expenses involved in travel to Liverpool

Free import export policy

The government of Pakistan has been following a free market mechanism in cotton trade. The textile industry strongly supports this policy, despite the annual shortfall in supply of around three million bales.

Cotton farmers receive export parity prices for their product. This season, cotton farmers earned around $ 2.35 billion more than previous years.

Prospects and vision

The textile industry is conscious of the emerging changes in the world textile and clothing trade. In view of growing competition, both producers and the government are revising their strategies and policies.

The government has announced the first-ever, five-year National Textile Policy, setting a textile and clothing export target of US$25 billion by the year 2014.

The policy aims at restructuring and reorganizing the industry during the next five years.

Key initiatives taken under the policy include: the creation of a Textile Investment Support Fund, a Technology Upgradation Fund; infrastructure development, skills development, zero tax on exports, and tax free imports of machinery.

Despite all the odds, the textile industry has improved its bottom line and is ready to plough back its earnings for capital formation, given the enabling environment. With encouragement and support from government, APTMA members visualize attainment of the export target by 2014, with investment of one billion US$ per annum resulting in the creation of job opportunities for one million workers. Subject to the presence of an enabling environment, investors are keenly looking forward to expansion of modern weaving, processing and woven garment manufacturing facilities.

New Initiatives in the Bangladesh Textile Industry: A Few Thoughts

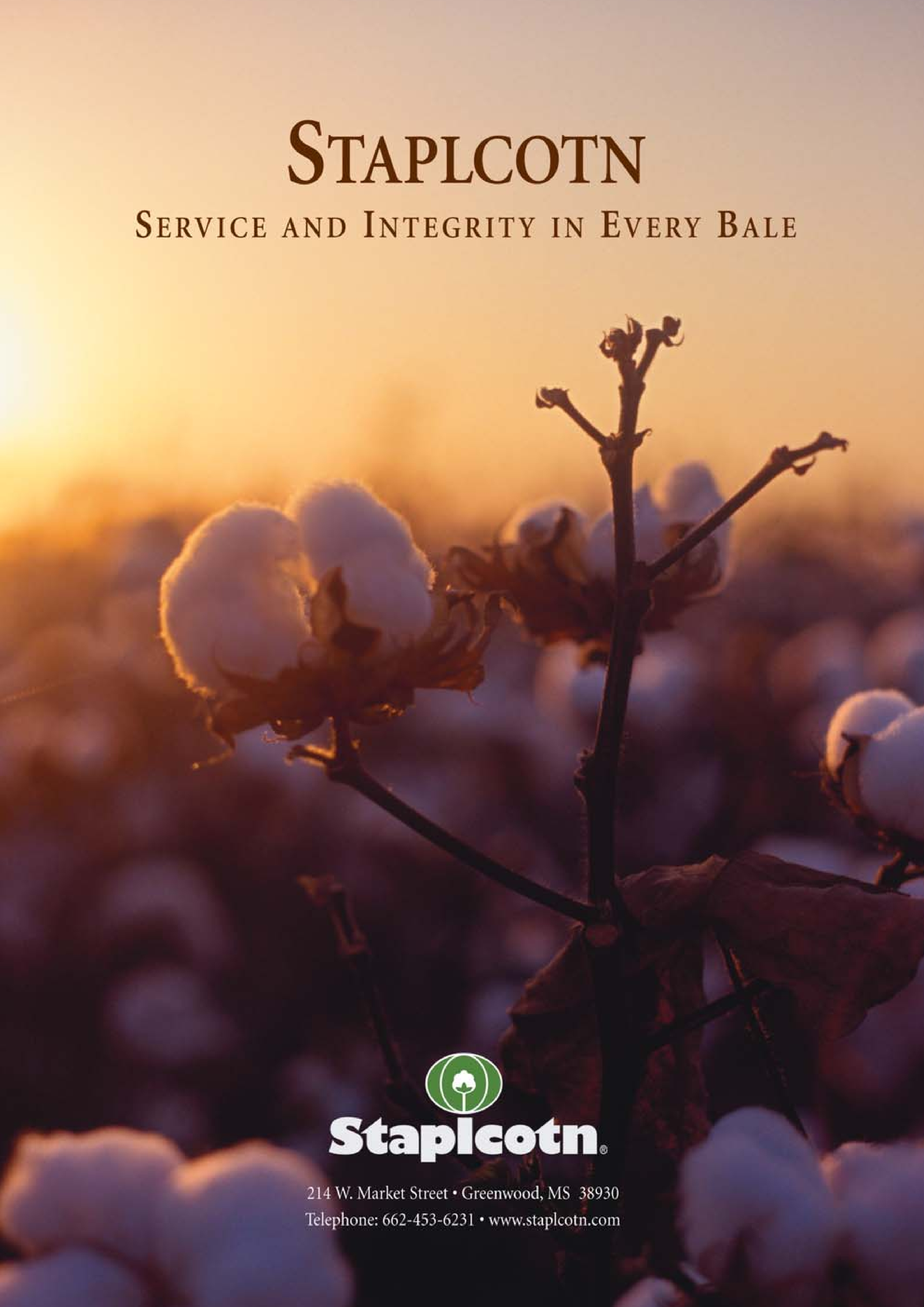
By Dr. Quamrul Ahsan Editor-in-Chief, Cotton Bangladesh

Bangladesh's textile industry has been recently experiencing crucial challenges. In a pivotal cotton season, 2010-11, the industry faces two choices on the supply chain: maintain the status quo or make a breakthrough in securing cotton supply. The latter offers the most appealing choice. One must understand that Bangladesh is uniquely placed in the textile world and possesses many advantages over its competitors, mainly India, China and Pakistan. It is the only country, among the major textile producers, that does not produce any raw cotton and has to import its entire requirement from the international market. Unfortunately, this has become an Achilles' heel, which can leave the textile industry in a vulnerable state. Therefore, the industry must look beyond the horizon, think larger than the world it lives in, and share a passionate vision with next generations that would go beyond the boundaries.

Two seasons, 2007-08 and 2009-10, provided an eye opening experience for Bangladesh's textile industry. Due to the commodity market turmoil of March 2008 and the uncertainty that lasted for the rest of that season, the world watched a few well-known cotton merchants fall to their demise. That was the most significant setback for the Bangladesh textile industry; a few reliable and dependable partners in its supply chain were lost. The 2009-10 cotton season posed a different challenge for the industry: the market crossed a then unexpected level of 100 cents/lb (Uzbek C&F Chittagong). We have seen the market since cross another record of 220 cents/lb in recent weeks. Although spinners have been hit by soaring cotton prices, the yarn markets have been giving them support for their higher production costs by providing better yarn prices. The real problem for our textile industry, however, is not the price but a "secured" cotton supply. This has been a frustrating experience for spinners during the last and current seasons.

Uzbekistan, a producer of high quality cotton, and India, Bangladesh's next-door neighbor, have been playing an important role as sources of cotton. The increase in Indian market share in Bangladesh in the last four years demonstrates a natural strategic alliance between the cotton industries of both countries. In 2010, Bangladesh managed to import 32 percent of its cotton from Uzbekistan, 28 percent from India, 12 percent from Africa, 7 percent from the USA, 9 percent from Turkmenistan and 12 percent from other countries. Four years ago, however, the dynamics were different, with 65 percent of imports from Uzbekistan, 10 percent from India and the remaining 25 percent from other countries.

Bangladesh seemingly becomes more dependent on Uzbekistan and Indian cotton, and, lately, India has become the dominant source of cotton for the textile industry. Unfortunately, dependency on only two sources puts Bangladesh in a vulnerable situation. Especially, the geopolitical risks and government control over cotton export in these two countries have made the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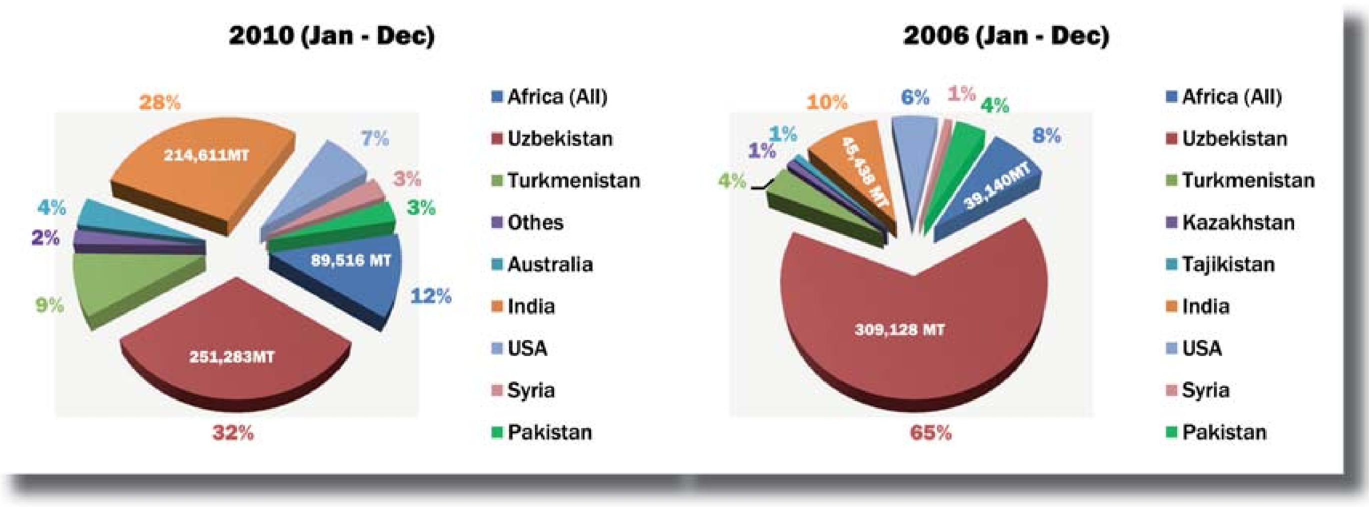
Dynamics of Cotton Imports in Bangladesh, 2006 and 2010



situation far worse then the industry anticipated. Therefore, Bangladesh must find an alternative to secure an uninterrupted supply of raw cotton.

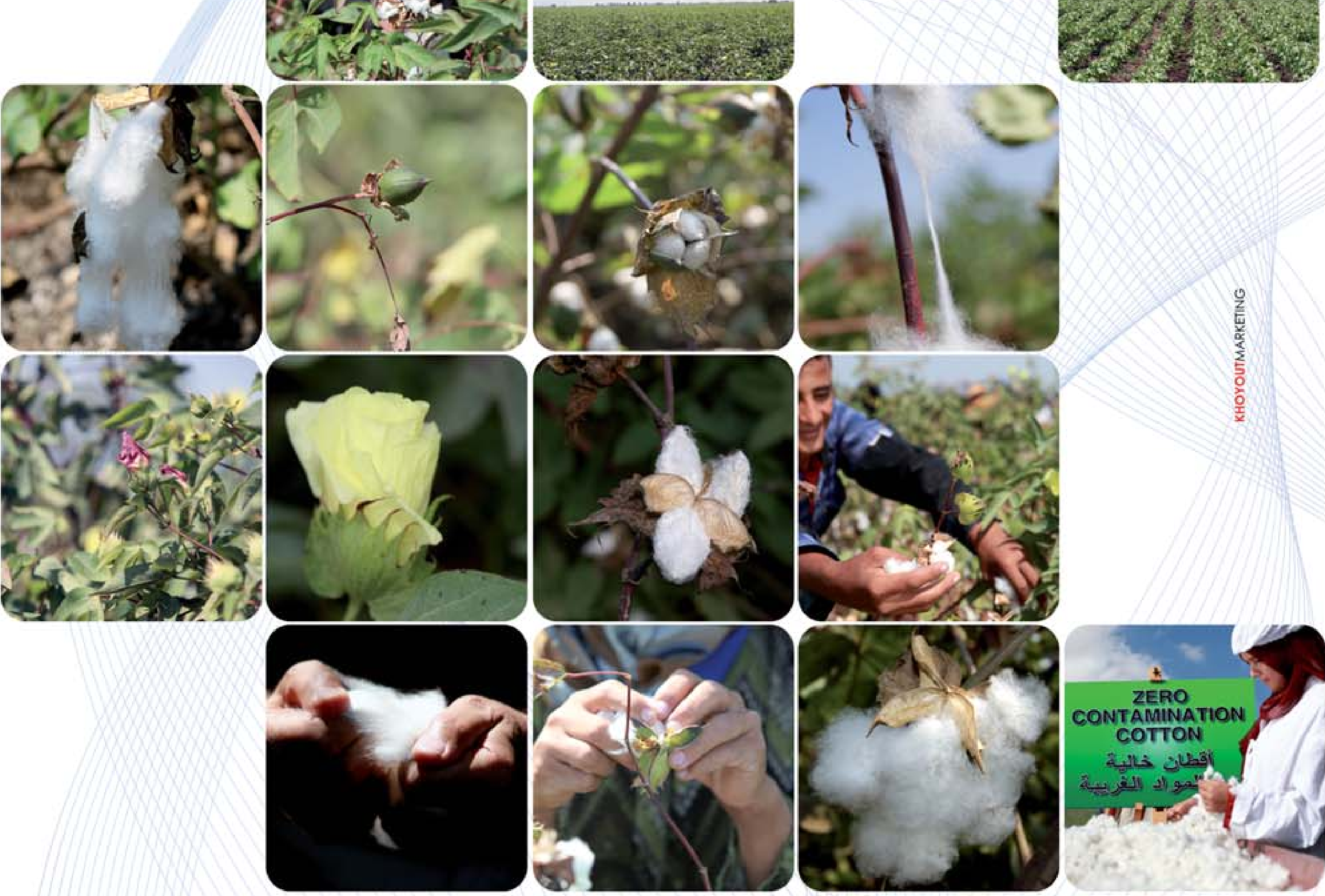
Disruptions in the supply chain are intrinsically linked to economic and national security of Bangladesh. Events as small as port congestion, or as major as geopolitics, weather or government interference, may affect export and import trading negatively. Bangladesh must create an institution that can anticipate geopolitical risks in sourcing cotton. This institution would evaluate and predict future setbacks in supply, which are serious national security issues. An alternative plan based on various scenarios should be in place and ensure an uninterrupted supply of raw materials for the industry. We believe that a strategic reserve of two to three months supply of raw cotton could provide a first line of defense against any interruption in the supply chain. We do not suggest that the Government should step in and make this reserve; rather, the industry itself should be able to manage this challenge. We are confident that, with a little political, banking and institutional help from the Government, our industry alone can handle this challenge fairly well.

Where should we look for cotton? Bangladesh buys most of its cotton from Uzbekistan, India and Africa. These growths are of better quality, cheaper and more cost effective. Uzbekistan grows a few of the best varieties of cotton in the world, and their cotton offers better 'spinability'. Unfortunately, in recent years, the supply from Uzbekistan has been getting tighter because of their controlled sales strategy and increased domestic use. Chinese companies are also buying more cotton from Uzbekistan. In the current season, Government has put increased control on cotton exports, contributing to a tighter supply and a higher price. Bangladesh currently faces intense competition for supplies in Uzbekistan.

India provides an excellent alternative to Uzbek, owing to improvement in quality and consistency every year and competitive prices. India has the potential to be a strategic source for Bangladesh for several reasons. India, the second largest producer of cotton in the world, is our next-door neighbour and, potentially, can grow more cotton through increasing productivity and bringing more acreage under cotton cultivation. Cotton farming and ginning have been modernized in the last few years. The major problem with Indian supplies is political interference, which has occurred in recent months and which has undermined our reliance on this source.

African countries (both West Africa and East Africa) also offer an excellent potential for becoming a strategic source for Bangladesh. Unfortunately, the total volume of production from Africa is very limited. Unlike India, this source does not pose any serious government control on export but more and more sources are being paralyzed by political instability; the Cote d'Ivoire's recent political stalemate has caused a serious setback for the cotton industries in Burkina Faso and Mali, especially in regard to shipping cotton using Abidjan port. Logistics and transportation have always been a challenge for cotton exporters from Africa.

Now should be the time for Bangladesh to encourage its companies to merchandise raw materials including cotton, invest in foreign countries (including setting up ginning factories) and trade cotton directly from foreign farmers and government agencies. Companies should be able to trade cotton all over the world. If Bangladesh companies can secure cotton in this way, the textile industry would be better secured. Bangladesh companies would team-up with companies with local knowledge and experience to develop farmlands and cultivate cotton in foreign countries. Africa offers an excellent choice for such a venture. This would ensure a raw materials supply for the textile industry, which is vital for our economy and national security.


ZERO
CONTAMINATION
COTTON
أقطان خالية
من المواد الغريبة

The 2009-10 and 2010-11 cotton seasons have given us a wakeup call to prepare ourselves for the future and a realization that "finding cotton" is an issue rather than the "price". It has reminded us that our textile industry is vulnerable to foreign sources of supply and that Bangladesh depends on the textile industry for 76 percent its foreign earnings. This is more of an issue of national security than merely cotton security.

Another challenge for Bangladesh is the lack of an institution that can train and employ cotton experts, economists and statisticians. A well-established institution is necessary, where economists and scientists can study the cotton market and give direction to our industry leaders and policy makers, who are facing unprecedented challenges. We strongly suggest that a National Textile Council (NTC) be formed through a public and private partnership effort. The council should comprise five major industry associations: Bangladesh Textiles Mills Association (BTMA), Bangladesh Cotton Association (BCA), Bangladesh Garments Manufacturer and Exporters Association (BGMEA), Federation of Bangladesh Chamber of Commerce and Industries (FBCCI) and the Government. The NTC, as a think tank, can perform research on cotton markets, cotton sourcing, and textile markets. The NTC would also employ world-class economists, statisticians and scientists. Members would regularly participate in international forums, gain experience, develop professional connections with world industry leaders and study and develop new markets. They would also examine and understand the strength and weakness of our industries, as well as those of our competitors, and develop programs to create more experts, who could provide guidance and technical direction to policy makers and industry leaders.

While Bangladesh's textile industry needs to be active in a number of international and national issues, participation in international forums would also provide a strong voice for our industry, enabling concerns to be raised and issues to be resolved with our strategic partners. We would like to see a collaborative effort by all the major cotton and textile associations of Bangladesh to organize conferences and seminars. Membership should be sought of the International Cotton Advisory Committee (ICAC), the International Cotton Association (ICA) and other important international forums. This kind of participation would allow us to brainstorm ideas for all the parties who have stakes in the development of our textile industry, and facilitate interaction with international experts.