Cotton Outlook
Long Staple UPDATE
December 2014

Shifting price relationships

Supply and demand

World production of long staple cottons during the 2014/15 season is estimated at over 424,000 tonnes, which would represent a recovery of 14 percent from the estimate of production for the previous season, the smallest of recent years. The latest world output number also represents a significant increase from the forecast advanced in our annual Long Staple Special Feature, published in early August.

World LS Output (tonnes)

	2010/11	2011/12	2012/13	2013/14	2014/15	2014/15 v 2013/14
United States	109,755	185,327	169,782	138,037	125,845	-9%
Egypt	120,809	168,482	96,917	86,904	114,415	32%
of which:						
ELS	27,921	39,547	9,154	4,762	3,214	-33%
Giza 86	92,888	128,935	87,764	82,142	111,200	35%
Sudan	4,482	17,000	15,000	857	-	-100%
Uzbekistan	2,000	2,000	2,000	1,500	1,000	-33%
Tajikistan	180	850	1,000	700	500	-29%
Turkmenistan	24,000	21,000	18,000	16,000	16,000	0%
India	62,500	72,000	65,000	75,000	85,000	13%
Peru	5,000	8,000	8,000	6,000	4,500	-25%
China	120,000	130,000	60,000	35,000	58,000	66%
Israel	7,000	15,500	14,500	11,000	13,900	26%
Spain	2,250	3,100	1,370	1,820	5,000	175%
Australia	500	990	600	-	-	-
Total	**458,476**	**624,249**	**452,169**	**372,819**	**424,160**	14%

World LS Consumption (tonnes)

	2010/11	2011/12	2012/13	2013/14	2014/15	2014/15 v 2013/14
Americas						
United States	6,000	6,800	4,790	4,354	5,443	25%
Mexico	600	785	725	600	700	17%
Peru	11,000	13,000	13,000	12,000	13,000	8%
Europe						
Italy	3,000	2,000	3,000	3,000	3,000	Unch
Switzerland	4,000	1,500	2,000	2,000	2,000	Unch
Germany	5,500	1,000	2,500	5,000	4,500	-10%
Turkey	7,000	10,000	15,000	17,000	14,000	-18%
Portugal	600	400	400	500	750	50%
Asia						
China	165,000	205,000	155,000	125,000	130,000	4%
India	95,000	95,000	120,000	130,000	130,000	Unch
Pakistan	30,000	40,000	45,000	25,000	30,000	20%
Indonesia	9,000	6,200	7,000	7,200	4,500	-38%
Japan	9,500	3,500	4,000	3,800	4,500	18%
South Korea	5,500	5,200	2,600	2,800	2,600	-7%
Bangladesh	6,000	12,000	12,000	11,500	12,000	4%
Thailand	5,000	8,000	9,000	5,200	6,000	15%
Taiwan	3,000	2,000	1,500	800	1,000	25%
Turkmenistan	2,000	3,500	3,500	3,500	4,000	14%
Africa						
Egypt (ELS + G86)	26,803	56,383	65,206	37,407	38,000	2%
Others	4,000	4,500	4,500	4,500	4,500	Unch
Total	**398,503**	**476,768**	**470,721**	**401,162**	**410,493**	2.3%

The most significant upward adjustment concerns the US Pima crop, earlier forecast at just below 93,000 tonnes but which (with the harvest and ginning well advanced) is predicted to yield just below 126,000 tonnes of lint. Acreage increased from spring and early summer projections and yield estimates were adjusted higher as the season progressed. Despite the continuation of extreme and exceptional drought, the hot, dry growing season was beneficial for cotton output in California. More modest upward adjustments have also been made to the figures for Egypt, India and Spain, as well as for Israel, which reports the attainment of record yields for Pima and Acalpi.

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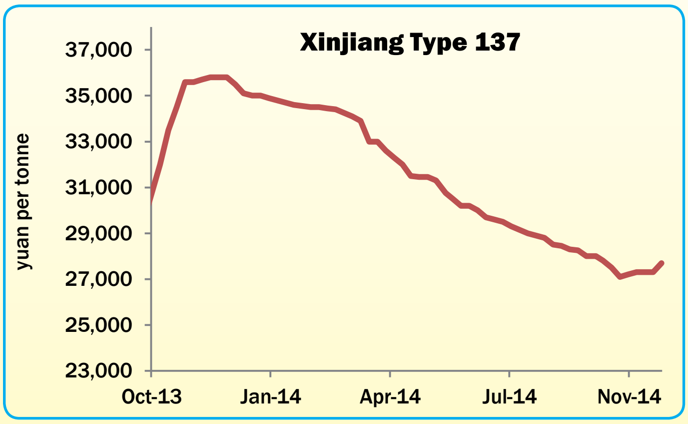
Lower than anticipated yields explain a small decrease in the figure for China. Despite the collapse of upland prices, Australian producers have not been tempted to plant even a token Pima crop, while those in Sudan have, for the time being, abandoned Barakat, largely, it seems, in favour of Bt Acala.

Since harvests are complete or well advanced in most producing countries, long staple production can be assessed with a degree of confidence at this stage in the year. However, to forecast consumption represents a greater challenge, in the context of rapidly shifting price relationships, both within the fine count sector, and between long staple and upland prices.

Our forecast of global consumption, slightly above 410,000 tonnes, falls only modestly short of estimated world production. The total implies growth of 2.3 percent in respect of the previous season. That improvement could become more pronounced, if weakening prices continue to narrow the gap with upland cottons.

Slow market

Tentative signs of an improvement in long staple demand have been a very recent phenomenon. The main characteristic of the world long staple market during the early stages of the 2014/15 season was the lack of buying interest from virtually all major export markets. Only on one occasion this season has USDA's weekly export report mentioned sales of more than 10,000 bales, and cumulative export sales are the lowest at this point in the season since November 2008.



Conspicuous thus far by its absence has been the strong import demand from China that was a major feature of the first half of the 2013/14 campaign. Sales to that market amount to less than 15 percent of those recorded a year earlier.

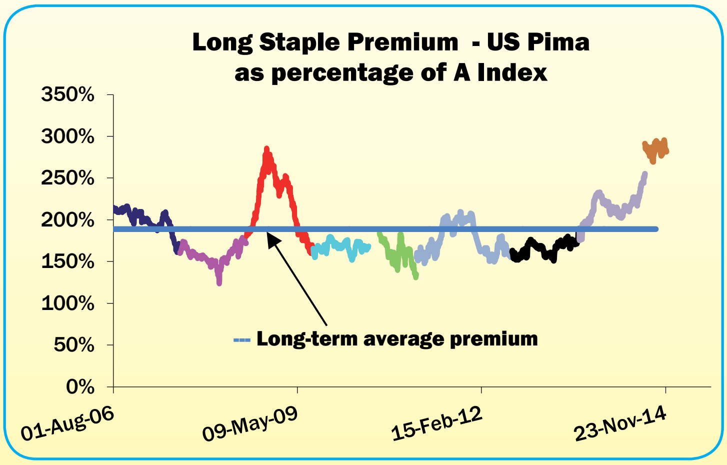
One reason is of course a partial recovery of China's own long staple output, which had fallen to an estimated 35,000 tonnes by 2013/14, the third and last season under the state reserve procurement arrangements that provided Xinjiang's producers with little incentive to cultivate long staple varieties. Although yields have proved a little lower than expectations, this season's output represents an increase of 66 percent from last season's low point. Anecdotal evidence indicates that ginners are encountering a good demand for the new season's production.

Recent reports have also mentioned more stable prices, following a lengthy period in which long staple prices were in decline. At 27,700 yuan per tonne, the latest prices quoted for Xinjiang Type 137 compare favourably with import parities for US Pima.

The early pattern of sales from Egypt was scarcely more impressive. Export sales registered since the beginning of the Egyptian season (September 1) amounted to less than 13,000 tonnes by November 29, still behind even the pedestrian pace witnessed last season. Three quarters of the season's registrations were recorded in the two weeks prior to that date, which suggests that discounted prices are beginning to stimulate some demand from customary markets.

Long staple and upland prices

The recent slowness of demand for American Pima is perhaps unsurprising when one considers that its price premium, relative to upland cotton, has been at an historical high – in large part, of course, as a result of the collapse of upland prices over the past few months. At the time of writing, our Pima quotation stands at 187.00 cents per lb, CFR Far East, down from a peak of 210.00 that persisted



through August and early September. The current value still represents an exceptionally high premium of almost 180 percent over the Cotlook A Index. The long-term, average premium is just below 90 percent.

Despite that disparity, and the aforementioned slowness of export demand, producers of American Pima have proved reluctant to reduce their offering rates. That stance has been influenced by perceptions of a tight supply position, but also by concerns regarding the amount of water that may be available to irrigate the 2015/16 Pima crop.

Competition in the specific market segment occupied by American Pima (84 percent of the 2014/15 crop was classed as 48 staple) is restricted. In Egypt, Giza 88 plantings this season have dwindled, and output is commensurately small, pending the availability for commercial production of a replacement variety. Israeli Pima otherwise represents the world market's other significant source of premium quality Extra-long Staple supply.

In contrast, a continuing theme of commentary on the fine count sector has been the blurring of the boundaries between longer staple upland cottons, whose typical length has risen impressively in recent seasons, as the fruits of varietal development programmes have become apparent, and those such as Giza 86 or MCU-5 at the lower end of the traditional long staple range. Developments in spinning technology, which allow the production of relatively high count yarns from cheaper cottons, represent a part of this story,

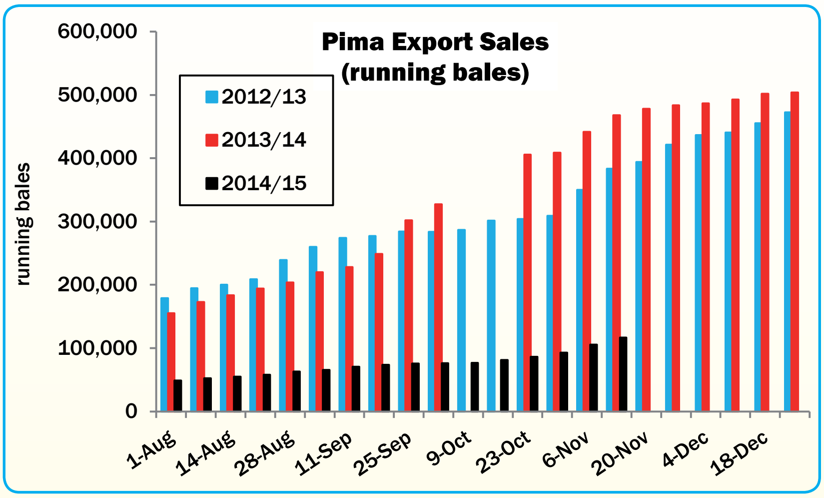
This underlying trend may this season prove to be intensified by the quality deficiencies associated with a portion of the 2014/15 Giza 86 crop, as noted elsewhere in this publication. Asking prices for Giza 86 fell sharply during November, in part to reflect the downturn of domestic seed cotton values, but also no doubt influenced to some extent by the aforementioned quality concerns. The price decline had given rise to anticipation that the US Competitive Adjustment Programme would be triggered, which would have led to a massive government payment to exporters of US Pima. In a surprise announcement on December 4, however, Washington stated that it had taken note of the quality deficiencies in this season's Egyptian Giza 86 output, and that it had therefore withdrawn Giza 86 from the list of comparable growths for the purpose of calculating a payment, leaving Egyptian Giza 88 and Israeli Pima as the two remaining yardsticks. Hence, the prospect of a 'Competitive Adjustment Payment' being forthcoming in the foreseeable future has been eliminated.

US Pima outlook

Softer Pima and competing prices in the world market have followed a slow pace of business, while most attention has been on much cheaper upland growths and a falling futures market.

Pima yields and quality this season have been good, despite seriously limited water resources in the Far West growing region, and in the San Joaquin Valley in particular. USDA has projected average Pima yields in the US at 1,465 bales per harvested acre for total production of 578,000 bales in 2014/15. At this point in the season, Cotlook has adopted Washington's forecast for Pima output and domestic use.

Pima production at 578,000 bales is just above the export forecast of 550,000 bales for the 2014/15 season. Some private forecasts place production below the level of expected exports this year. Through November 13, total export commitments of US Pima were recorded at 116,600 running bales for the season thus far, compared with 467,500 running bales by the same period last year. Pima export sales are in fact lagging very significantly behind the pace of the past two seasons, as illustrated in the accompanying chart.



Yield and quality reports have been favourable for this year's Pima crop. Through November 13, all colour and leaf grades were good, and an estimated 84 percent of cotton classed was staple 48 and longer with 14.1 percent classed staple 46. A total 188,226 bales had been classed in the Visalia office as last reported.

Looking to next year, the exceptional drought in California remains an enduring and major cause for concern.

Farmers are allocating limited water resources to permanent crops in place of cotton acres. Without heavy mountain snowpacks and adequate winter rains in the coming months, cotton production will again see a reduction in planted acres, come the spring.

US Pima supply and Demand

ELS Cotton:		2012/13	2013/14	2014/15
Planted acres	1,000 acres	238	201	192
Harvested acres	"	237	199	189
Yield/harvested care	lbs/acre	1,581	1,527	1,465
Beginning stocks	1,000 bales	269	187	125
Production	"	780	634	578
Omports	"	4	7	5
Total supply	"	1,053	828	708
Domestic mill use	"	22	23	25
Exports	"	844	680	550
Total disappearance	"	866	703	575
Ending stocks	"	187	125	133

Source: USDA WASDE November 2014 report.

Merchants and cooperatives, as well as mills, have all been eyeing lower foreign prices in anticipation that a potentially large US Pima Competitiveness Payment would be triggered.

The US Pima Competitive Adjustment Programme was established in the Federal Agriculture Improvement and Reform Act of 1996, and has been retained in subsequent legislation, including the latest Farm Bill, signed by President Obama in February of this year. It is analogous to the Upland 'Step 2' program, which was discontinued at the end of the 2005/06 season.

The programme provides for payment of a subsidy to domestic users and exporters, when world prices are deemed to have been below US long staple values for a period of four weeks, and the lowest-priced competing growth is equal to less than 134 percent of the ELS loan rate. Prior to the late news regarding removal of Giza 86 as a comparable growth, those conditions appeared to likely to be met before the end of the calendar year.

The basic ELS loan rate 79.77 cents is adjusted for quality to a 2-2-46 for a resulting 81.60 cents. The cheapest foreign competing quote (adjusted for quality and transportation) must be lower than 134 percent of the adjusted 81.60-cent loan rate (109.34 cents) for four consecutive weeks for Pima Competitiveness Payments to be triggered.

Egyptian developments

2014/15 production outlook

In our 2014 Annual Long Staple Review, planted area for the 2014/15 season was estimated to have increased by some 27 percent but the final gain is shown to have been over 29 percent, according to data published by the Cotton Arbitration and Testing General Organisation. CATGO's total figure is 375,979 feddan (around 158,000 hectares). The figure is nevertheless more than 100,000 below the average level recorded during the first eight years of this century.

Crop progress reports throughout the growing season were couched mostly in reassuring terms but the harvesting period has been characterised by slow movement of cotton from field to gin and by deepening concern about the quality and ginning outturn forthcoming from the Giza 86 long staple style. Deficiencies in fibre length, strength and appearance have been evident in early classing results. These have impacted market prices.

Egypt's planted area
2014/15 season

	feddan	hectares
Giza 88	1,539	646
Giza 92	8,678	3,645
Giza 93	77	32
Giza 86	333,935	140,277
Lower Egypt total	344,229	144,601
Giza 80	396	166
Giza 90	29,954	12,583
Upper Egypt total	30,350	12,749
Other	1,400	588
Grand total	**375,979**	**157,939**

Based on the revised area under cultivation, a prospective lint output might be foreseeable, if yields are close to the average in recent years, of around 127,000 tonnes, including some 111,000 of Giza 86 and slightly more than 3,000 of ELS styles, the balance consisting predominantly of Giza 90.

Informed commentators indicate that strenuous efforts are under way to bring to commercialisation new seed strains that will perform better, including a replacement for the Giza 88 extra-long staple style, the area under which has contracted sharply in recent seasons.

Declining prices of concern to farmers

Awareness of the bearish outlook for prices during the 2014/15 season had already spread considerable unease

among cotton farmers, and much discussion of a potential direct subsidy from government may have contributed to farmers' initial lack of enthusiasm in delivering seed cotton supplies. Whilst an official ban on cotton imports was not considered, a first step to support the internal market appeared to consist of administrative measures that had the effect of slowing the import pace. Subsequently, the government announced a provision of E£525 million (about US$75 million), of which £425 million consisted of new funding and the balance carried over from previous subsidy schemes, to be used to subsidise cotton farmers – the first ever such direct payments. The amount is payable against cultivated area. It was anticipated that the news would encourage farmers to bring seed cotton to market.