

Cotton Outlook

Special Feature

October 2017



ICA Singapore 2017



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ICA – back on the road

Ray Butler, Managing Director, Cotlook Ltd.



In 2016, the International Cotton Association celebrated the 175th anniversary of the foundation of the Liverpool Cotton Brokers’ Association by returning its annual trade gathering to Liverpool for the first time in three years, following events during the preceding three years in Hong Kong, Dubai and California. This year, the ICA show is back on the road, revisiting Singapore, and thus the trade event once more takes place close to today’s centres of raw cotton consumption, a fact that will doubtless be reflected in the make-up and size of the audience. *Cotton Outlook* continues to be a proud supporter of the ICA and is delighted once again to work in conjunction with the Secretariat, including outgoing Managing Director Kai Hughes

(to whom we express best wishes for the future) and the principal officers of the Association, on the production of this Special Feature.

The Special Feature contains a number of articles focused on aspects of the cotton industry in Asia, and also gives viewpoints from representative organisations from some of the leading origins supplying raw cotton to the region. To our contributors, we express heartfelt thanks for their efforts. The coverage is not comprehensive (since that would demand more pages than this publication can accommodate!) but the aim is to give the reader a flavour of some of the current topics under discussion in the cotton trading world, and provide some background and context for the Singapore meeting. We trust you find it useful.



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Consolidating the past – looking to the future



Jürg Reinhart, President, International Cotton Association

As my year as President of the ICA comes to an end, I can reflect on 12 months of consolidation and change. Consolidation efforts were focused on the completion of a major review of the Articles of Association – the rules governing membership of the ICA. The most important change is that we must say goodbye to our Managing Director, Kai Hughes, after nearly 10 years in post, and are now looking towards a new era of leadership at the Secretariat of the Association.

Consolidation doesn't sound very exciting, but it has become a top priority after the many changes in the ICA during the past 10 years. Our Association has evolved over several decades from a European/American merchant-based organisation into a global organisation of the entire industry. We can all look back with some pride to successful developments in the recent past, which I would like to summarise here.

In 2004, the Liverpool Cotton Association became the International Cotton Association, and this was the starting gun for changes that have continued to this day. A mission statement, a vision and a strategic plan were developed and became the core of all our decision making. The composition of the Board was adjusted to reflect the more international

membership and to recruit more spinners to serve on the Board of Directors as well as on committees. Membership was restructured; we added new categories such as Agents, Affiliated Associations etc., and this has led to a considerable increase in membership numbers over the last 10 years. Mill membership increased three-fold in that period. The composition of the Board has become truly global, and the

directors now represent over 14 nationalities and many different membership categories. During the last decade, we saw Presidents for the first time from South America, Africa and Asia. My successor, Salman Ispahani, from Bangladesh, will be the second overseas spinner to become President.

Kai has devoted considerable time and effort to proposing improvements to the ICA arbitration process and culture, and to ensuring that the process conforms to best practice in international arbitration. Greater transparency of the arbitration system and consistency in decision making were achieved by the formation of an Arbitration Strategy Committee, consisting of five elected and five nominated Chairmen, who meet frequently to discuss their response to strategic arbitration issues. This approach has ensured that both the Arbitration Strategy Committee and Rules Committee are dynamic and that our Bylaws and Rules meet the needs and changing circumstances of the trade, but can also withstand legal challenges.

With the relocation of the office in 2011 from the Cotton Exchange to Exchange Flags, where cotton brokers conducted business in days gone by, a new strategy had to be developed concerning the Association's quality testing procedures. An agreement was made with the Bremer Baumwollbörse (BBB) to form ICA Bremen, a joint venture company that combines the technical expertise of the BBB and the Fibre Institute (FIBRE) of the University of Bremen with the reputation and international reach of the ICA. The laboratory, based in Bremen, employs state-of-the-art testing equipment in a brand-new laboratory, classing room and cotton standards room. The new company, managed by the ICA, immediately began to establish itself as the foremost quality testing and research centre in the cotton world. In just five years, in addition to its normal testing services, ICA Bremen



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Internationalisation of the ICA gathered momentum. We entered into strategic partnership MOUs with the Cotton Association of India and the China Cotton Association, thereby strengthening our relationships with two of the biggest cotton producing and consuming countries in the world. In 2010, the ICA held its very first trade event outside of Liverpool, in Singapore. That event was a resounding success and served as a blueprint for subsequent dinners in Dubai, Hong Kong, San Francisco, and this year once again in Singapore. However, members also missed the history, tradition and architectural splendour of the event in Liverpool, as well as the dinner held in the magnificent surroundings of St George's Hall. So, it was with a great deal of excitement that we returned to Liverpool last year to celebrate the Association's 175th birthday. The event was spectacular and covered the history of cotton and the Association through the past 175 years. It is worth mentioning that the event was awarded a prize as the best trade event dinner by the Trade Association Forum – an organisation representing just under 300 trade associations in the UK.

To keep up with the rapid development of recent years, it has become necessary to adjust the Articles, and, in particular, the Objects and disciplinary procedures of the Association.

It was pretty obvious that these rules were written at a time when the vast majority of members were based in Liverpool and could turn up for a meeting of the members at short notice. The days of an

international Board of Directors or of a membership spread wide around the globe were most probably not even considered when the Articles were written, and they clearly did not take account of technical innovations, such as electronic voting. So, a main part of our work during the past year has been to bring the Articles and Objects of our Association up to date and make them fit for purpose for a truly international organisation.

Another major consolidation was the end of a two-year High Court battle to defend the rules surrounding our arbitration process and the Arbitrator's Code of Conduct. The case was brought against the ICA by one of its own arbitrators and specifically concerned two rules – commonly known as the '3 and 8 Rules'.

The '3 Rule' stipulates that no arbitrator can act more than three times for a single party in each calendar year and was introduced to provide greater transparency into the arbitration system, preventing possible allegations of bias or criticisms on the grounds of conflict of interest. The claimant in the High Court case stated that this rule was a restraint of trade – even though the '3 Rule' is more generous than the guidelines of the International Bar Association – and that it was the arbitrator who should gauge whether a conflict of interest existed. That argument was not accepted by the High Court.

The '8 Rule' stipulates that an ICA arbitrator shall not have more than eight open cases at any one time. The purpose is to prevent arbitrators from taking on too much work and causing delays in the system. Since the rule was introduced, the average time taken to complete arbitrations has fallen from 392 days at its peak in 2014 to 286 days as I write this article – and it continues to fall.

We all greatly regret that the case couldn't be settled amicably, but the Court's decision at least had the positive effect of clarifying and consolidating our legal situation. The case was unique as no one



had ever before challenged an arbitral body's right to set its own rules. The outcome shows that the Association is on the right path towards the goal of providing transparent, speedy and cost-efficient arbitration as a service to all. We will continue to strive for transparency and efficiency in order to increase confidence in the arbitration system; and we will ensure that all our arbitrators are not only qualified to the very highest levels in terms of professional knowledge and expertise, but also uphold the most exacting standards of impartiality, ethics and integrity.

But as I mentioned above, aside from all our work on consolidation, there has also been change.

It came as a surprise when in June of this year, our Managing Director, Kai Hughes, resigned to become the Executive Director of ICAC – the International Cotton Advisory Committee – based in Washington DC. It was under his watch that the ICA has undergone all the momentous changes outlined above, and his dedicated work and professionalism have been crucial to our success. We regret his resignation very much but we are thankful for his contribution to our Association, and wish him similar success in his new position. Besides, we are also happy to have a good friend at the helm of ICAC!

More change is yet to come. Time doesn't stand still, and the ICA needs to continue adapting to the ever-shifting environment. A main area for future development will be the use of technology and social media to improve efficiency and provide more services, and this year we embarked on an evaluation of our current IT systems and the ways in which we can integrate them better.

In general, our focus must always be to provide added value to members. In order to remain relevant and to uphold our fundamental principle of contract sanctity, we need to be truly representative of the entire cotton industry from farm to textile mill. Every new member adds power to the Association. How can we appeal to more potential members and how can we make it more attractive for them to join? Proposals to achieve these goals will be discussed by the Strategy Committee and the Board for implementation soon.

The International Cotton Association now moves into the next phase of its history. It is doing so from a strong base: healthy finances, a new Managing Director, a loyal and committed staff and a diverse Board of Directors.



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An interview with Salman Ispahani



Salman Ispahani, First Vice President, International Cotton Association

Cotton Outlook: Mr. Ispahani, congratulations on your accession to the post of ICA President. What aspect of the Association are you most looking forward to being involved with during the next 12 months?

Salman Ispahani: One initiative that has recently been introduced by the Association is a sub-group of the Board specifically created to look at the concerns of spinners. Whilst there have been many such initiatives in the past, this group has been able to move towards common agreement on certain issues mainly, I believe, because the group is small and consists of Directors from both the spinner and merchant communities whose common interest is the ICA. I am looking forward to really building on this progress, and also to raising awareness amongst my fellow spinners of the importance of being a member of an organisation such as the ICA, and of the value of its Bylaws and Rules in bringing stability to the trade.

CO: At a time of change for the Association, with the departure of Kai Hughes as Managing Director, what do you foresee as the main challenges for the Association in the coming year?

SI: We are, of course, very sad that Kai has decided to leave us, especially considering the major changes that he has brought to the Association over the past 10 years. We are currently recruiting his successor but it is unlikely that he or she will be in place before the end of 2017. This means that for the early part of 2018 at least there is going to have to be a period of consolidation whilst that person settles in and gets their feet under the table. The main challenge therefore will be

to ensure that the new Managing Director gets as much help and support as possible and that progress doesn't stand still even for a year. We are fortunate to have an excellent Secretariat that will manage the transition, but they will still need leadership and guidance from the Directors.

CO: The ICA membership is increasingly widespread and diverse, which has of course been a policy goal for some years. Good progress has been made in developing engagement in Asia; how can the Association consolidate this engagement, and are there any markets in which you would like to see ICA's visibility improved?

SI: Considerable progress has been made regarding engagement in Asia, but there is still a lot of work ahead. Our engagement in Vietnam and Bangladesh, for example, suffered greatly after the volatility of 2010/11, and the numerous defaults that resulted in those markets at the time. Rebuilding relationships between the major associations will require some effort. In other markets, such as Indonesia, we have had only sporadic engagement and none at all with any spinner associations. This means we can approach an engagement with them with a clean slate. But we mustn't forget those countries and associations where we have already built strong alliances, such as China, India and Pakistan. We need to be continually building on these special relationships, making them stronger.

CO: In recent years, the ICA has implemented new initiatives, such as its partnership with the Bremer Baumwollbörse in the creation of ICA Bremen and signing MOUs with various sister associations, and has tried to pursue others that have proved less fruitful. What new initiatives do you think might be forthcoming in the foreseeable future?





SI: If you are viewing initiatives in terms of partnerships, then our priority must be to develop partnerships with associations in Bangladesh, Vietnam and Pakistan, as these are hugely important markets. In terms of other initiatives, the ICA recently launched its Professional Certificate in Commodity Management. The first module sold out and proved to be hugely successful. We now need to build on this online course and our other training programmes so that the ICA and its sister company ICA Bremen become not just the foremost cotton arbitral body, but also the premier provider of cotton-related training dedicated to improving knowledge and standards in the cotton world. In addition, we are exploring the online registration of contracts. This will be a huge challenge as there are currently many concerns about how this can be done effectively and accurately, but most importantly, securely. In many ways, the discussions are similar to those concerning electronic banking and PayPal transfers that took place a few years ago; and indeed, I envisage that in the not-too-distant future the electronic exchange of contracts and other documents will be as much a part of the way we do trade as the online transfer of funds. We need to be engaging in this debate now, to drive it so that the outcome fits our needs, and not let it leave us behind.

The Association has also started to look at initiatives concerning membership. We are keen not only to grow membership but, more importantly, to look at how we can add value to that membership and improve communications with members. This is a hugely important area and will form a major focus for the Board over the next year.

Finally, there have been many initiatives in the past addressing the default list, both in terms of reducing its size and preventing firms from ending up on the list in the first place. This year we have reached agreement on removing from the list firms that are bankrupt, and those that are no longer trading. We are also talking to other major dispute resolution bodies in those countries where we have significant numbers of defaults, promoting mediation; and, with regard to ICA Member firms who trade with defaulters (thereby undermining our efforts to ensure contract sanctity), we have strengthened sanctions, and will continue to do so.

CO: The ICA has been engaged in revising and updating its Articles and Bylaws and Rules in recent times. Do you foresee any further amendments as requiring urgent attention?

SI: I think I am going to be the first President for a number of years who is able to say that we are not planning any major amendments to the Articles or the Bylaws and Rules. The Arbitration Committee and Rules Committee have worked incessantly to ensure that our Bylaws and Rules are up to date and reflect what is happening in the trade. There will, of course, still be further changes that will need to come before the Board and Members, especially when we examine the proposals of the Board sub-group looking at spinners' concerns. But these changes are important and can only underline our commitment to ensure that the Rules are as equitable as possible with regard to both buyer and seller.

In addition, the recent High Court case involving the ICA and an ICA arbitrator revealed that we could, and should, do a great deal more to ensure that our arbitrators fully understand their responsibilities, and that the arbitration system is more transparent to its users. There is no doubt that huge improvements have been made to the system over recent years, but initiatives for more transparency and efficiency have often been blocked as a result of the self-interests of the few. The outcome of the High Court case in our favour was an important milestone for the Association; it means that we can move on and continue to build an arbitration system founded on the highest principles of integrity and impartiality.

Finally, I am pleased to say that the Articles have been completely reviewed by the Board, Governance Officer and Managing Director. This was the first time in many years that a complete review has been conducted and whilst there are still some minor points that need changing, the major areas covering the Objects of the Association, electronic voting and disciplinary offences (as well as the procedures for investigating them) have been totally revamped to make the Articles fit for purpose.

CO: Would you like to make any other comments for the benefit of readers, as regards your forthcoming year as President?

SI: The fact that ICA Members have elected a Bangladeshi spinner to be their President gives you a good indication of the direction the ICA Board and membership want to go. They want an Association that is international and inclusive of both buyers and sellers. The ICA is unique in that it is not burdened by national interests, and it fulfils an important function for the trade, bringing to it stability and order. For too long the ICA has had to face accusations of being a 'Liverpool Merchants Club' and that it somehow considers itself superior to everyone else. I hope that my appointment as President will be a catalyst for more cooperation between the ICA and spinner associations to find solutions to problems that affect us all and undermine our trust in each other. Of course, this will not happen overnight but I hope that I will be able to put in place the foundations for those partnerships, especially in those jurisdictions where levels of cooperation with spinner associations are low or non-existent. By achieving this, we will build a stronger ICA.



Indonesia: textiles' hopes rest on *Jokonomics*



John Erwin, Chief Representative, Sunrise Resources Ltd.

Textiles is one of Indonesia's oldest and most important industries, yet commensurate government support has been lacking for decades. However, the ascent of a new president in 2014 looked set to change that. Joko Widodo, popularly known as Jokowi, won the presidential election vowing to boost growth, attract investment and improve infrastructure. He claimed that his own commercial background (in furniture) gave him a special insight into the workings of business. Moreover, his origins are in Central Java, which is one of the country's main textile hubs.

Jokowi's populism is founded on his hands-on approach and his reputation for listening to the concerns of the business community and the people. In keeping with this, one of his first acts as president was to establish a WhatsApp group, called *Jokonomics*, through which he invited people to come forth with their own ideas to energize economic reforms.

Jokonomics

During the first three months of his presidency, Jokowi took the bold decision to end the decades-old subsidy for fuel that had placed a huge burden on government spending. Taking advantage of low commodity prices, Jokowi's administration pushed through with the reform. The cuts freed up 20 percent of the 2015 state budget, and the diverted funds contributed to a total of US\$20 billion available for infrastructure and education. To date, his administration has continued to focus on infrastructure as the number one spending priority. The new 2017 budget proposals show an increase to US\$29.06 billion

in the allocation for infrastructure, which means it now accounts for 19 percent of total government spending, a larger share than any other areas of expenditure.

According to the National Mid-Term Development Roadmap (2015-2019), Indonesia's infrastructure plans will need a total investment of US\$500 billion over the next five years. Jokowi has promised that the majority of these funds will come from the state budget, with the remainder acquired from other sources, including the private sector, regional budgets and state-owned enterprises.

As an archipelago consisting of 17,000 islands, Indonesia has one of the world's most challenging territories to build up and connect. It is hoped that by prioritizing infrastructure development, the administration will resolve some of the logistical bottlenecks that are giving rise to a high-cost economy.

To deal with other challenges, such as tax evasion, and in order to find new ways to finance government spending, Jokowi's administration also launched a tax amnesty programme, which ran from July 2016 to March 2017. The success of this programme in terms of asset declarations has led to it being labelled as one of the most – if not *the* most – successful such measures to be implemented ever, anywhere in the world. During the nine-month amnesty period, the government collected an extra US\$8.7 billion, almost 10 percent of the total tax revenue for 2016. However, Indonesia still needs to go further on tax reforms if it is to improve its tax-to-GDP ratio, which has decreased from 11.4 percent in 2012 to 10.4 percent in 2016.

To attract investment, Jokowi has made special efforts to enhance "the index of ease of doing business". Prior to Jokowi taking power, Indonesia was ranked among the worst countries in which to



do business by the World Bank. The new measures have had some success, and the country has moved from 106th to 91st place in 2017. But this is still a long way behind Jokowi's goal of 40th place, which he wants to achieve by the end of his first term in 2019.

The recent announcement by Standard & Poor, upgrading Indonesia to investment grade was a significant fillip for the administration. This elevated status indicates a level of confidence that the country can properly manage both its fiscal and monetary policies. The reform-minded, pro-business attitude and political power of Jokowi are factors that have generated signs of optimism in the Indonesian market.

Indonesia's textile industry in the global context

According to data from Indonesia's Ministry of Industry, the textile industry occupies 3 million workers, or 17 percent of the total workforce involved in manufacturing. The textiles and apparel sector contributed US\$11.87 billion of foreign exchange earnings, or 8.2 percent of Indonesia's total export earnings in 2016. Meanwhile, investment in this sector reached approximately US\$567 million in 2016.

However, with constant growth in GDP between 4 and 7 percent in the last decade or so, the textiles industry has struggled to capitalise on this economic development. Let us take export share as an example. In 2008, countries such as India, Vietnam and Bangladesh earned about US\$22 billion, US\$9 billion and US\$11 billion, respectively. In less than a

decade, India's exports have expanded to US\$35.5 billion, Vietnam's to US\$30 billion and Bangladesh's to US\$29 billion. The pace of change in Indonesia is snail-like by comparison. The industry now generates about US\$12 billion, which represents just 2 percent of the global textile market. The main factors still inhibiting growth in the textile industry are the lack of investment in new technologies, expertise and infrastructure, the absence of free-trade partnerships with other markets, and regulatory instability.

The cotton policy

This stagnation in the textile industry has had a negative effect on cotton consumption, which has not accelerated in Indonesia the way it has in Vietnam and Bangladesh. To address some of the constrictions in the spinning industry, Jokowi's administration initiated fifteen economic packages between September 2015 and July 2017. While many are sceptical and have said the packages are too general in their impact, several policies are intended to have a direct effect on businesses involving cotton. One that has stood out as helping the cotton spinning industry is the deregulation or amendment of the Bonded area, PP No. 23 / 2009. This operates in a manner similar to bonded warehouses in China and Vietnam. It allows shippers to consign cotton to Indonesia free of duty or tax and store it in a Bonded Logistic Center (known as a PLB) until local buyers are found, or else re-export the cotton to other countries. The purpose of this initiative is to provide a competitive edge to local





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Logistik solution for cotton business

Cotton - one of the strategic segments of Turkmenistan economy. Turkmenistan is one of ten top producers of cotton in the world, approximately each year Turkmenistan produces about 1.1 million tons of cotton. Great Silk Road Group exported cotton (fiber, yarn, linter, uluk, waste) for the companies such as: Olam International Ltd., Paul Reinhart, Ecom Agroindustrial Corp. Ltd, ICT Trading S.A., Darco Negoce S.A., Calik Cotton, Cargill, Louis Dreyfus Group.

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manufacturers by reducing storage and logistics costs, and by providing better access for consumers of raw materials.



The first-ever cotton consignment arriving at the new Bonded Logistic Centre (known as a PLB warehouse) in Indonesia, June 2016. Shipper: Reinhart; agent: Sunrise Resources Ltd.

Another positive policy change is the introduction of a fixed formula to determine increases in labour wages. This innovation provides certainty for the industry, and allows business owners to manage the wage structure in a simple, fair and predictable way.

Other policy changes have been directed at issues such as electricity, tax and logistics, but the implementation of these packages remains a difficult matter, impeded, as it often is, by bureaucracy. In consequence, the results for the cotton spinning industry leave much to be desired.

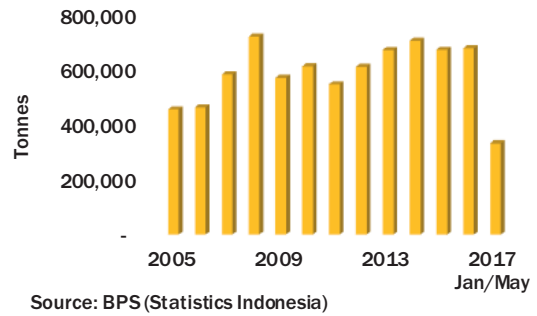
Outlook

For the last ten years, Indonesia has been reasonably resilient in resisting the impact of two major external disturbances: the 2008 financial crisis and two-dollar cotton in 2011. Nevertheless, in the period between these two key disruptions, Indonesian cotton consumption plunged from 720,000 MT in 2008 to 570,000 MT in 2009, although it has since recovered to 700,000 MT per year.

A further interesting development over the last few years has been the consolidation of the spinning industry. Smaller mills have closed down or been taken over by bigger conglomerates, some in preparation to go public at some stage in the future. During the same period, many large and medium-sized mills, particularly in West and Central Java, have been replacing old machinery and have expanded their capacity with new machines. Both West and Central Java have lower wage levels compared to other areas, for instance Greater Jakarta, due to the decentralized minimum wage system in Indonesia.

In the aftermath of the unforgettable 2011 event, a substantial tranche of cotton consumption has been lost to man-made fibres (MMF). It will be difficult to retrieve that share as changing fashion trends have also contributed to the transition. Furthermore, Indonesia is regarded as a production hub for more than 650,000 MT of polyester fibre and 500,000 MT of viscose rayon, and both are set to grow even more. Presently, MMFs are dominating

Indonesian raw cotton imports



the market, with a market share of 65 percent (40 percent polyester, 20 percent rayon and 5 percent others) compared with just 35 percent for cotton.

In addition to continuing research and development into new innovations in cotton production, education and raising awareness for the growing numbers of middle-class consumers will be extremely important. In a new report, the Boston Consulting Group predicts the number of Indonesia's middle-income and affluent consumers will double by 2020, to approximately 141 million people. This is too large a demographic segment to ignore.

Our company, Sunrise Resources Ltd., as a stakeholder in the Indonesian cotton industry, has decided to contribute in a positive way by embarking on a cotton awareness campaign. This will be conducted through social media platforms (Facebook, Twitter, Instagram, etc). The campaign slogan is #AyoPakaiKatun (Let's Wear Cotton). At this early stage, campaign efforts will be funded by Sunrise Resources Ltd. and Everseason Enterprises Ltd. based on a percentage contribution from the amount of cotton the two companies sell to spinners in Indonesia. We will soon be working together with a creative e-marketing company on this cotton awareness campaign in order to reach out to mainly young consumers.

Currently the campaign will be designed for social media only. These platforms are viewed as the most effective tool to target consumers across the country. With more than 120 million users, Indonesia is ranked as one of the nations with the most active participants on social media. In the future, Sunrise Resources Ltd.'s aim is to be able to work and campaign together with other cotton stakeholders in the country, including manufacturers, brands and retailers, as well as other organizations committed to the continued use of cotton.

Despite the many challenges to future growth in the spinning industry, including high lending rates of about 11 to 13 percent, and rising electricity costs, the consolidation that has already taken place will eventually improve market stability. It would not come as a surprise to us if, by the end of Jokowi's first term in 2019, cotton consumption had reached 750,000 MT annually. If Jokowi manages to secure a second term and is able to continue his reforms aggressively, then his aim to make Indonesia one of the top-five-ranking textiles exporters in the world may yet be possible and might ultimately prove that Jokonomics is more than just the name of a president's WhatsApp group chat.





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A bright future for textiles in Vietnam



Wu Faxin, CSO, Shanghai Shaxianbao Technology Co. Ltd.

The rapid development of the textile industry in Vietnam is indeed a miracle, when it is considered that cotton is not cultivated in this country. The 'miracle' was actually caused by many factors: Chinese enterprises have been moving their businesses to Vietnam in recent years, due to Beijing's strict 'cotton import quota' policy; the prospective favourable policies expected from the TPP (Trans-Pacific Partnership Agreement) attracted more and more international investors to set up businesses in the country; the 'free port' policy for cotton imports adopted by the Vietnamese government ensures a high-grade cotton supply is abundant; perhaps most significantly, local spinners enjoy advantages in production, especially for pure cotton products. In the last-mentioned regard, for example, the industrial electricity rate in Vietnam is equivalent to RMB 0.41 yuan per kilowatt-hour (latest price in July 2017), while the cost in mainland China is between 0.65 and 0.7 yuan. So, spinners in Vietnam have enjoyed very competitive cost advantages. In addition, the monthly labour cost is merely around US\$300, which is less than half of the equivalent cost facing businesses operating in China. These advantages in raw materials, electricity and labour costs have combined to promote the rapid development of the textile industry in Vietnam.

According to survey results, by the end of 2016, cotton textile capacity in Vietnam was around 8.5 million spindles (including Vietnam-based investment enterprises from China, Korea and Japan).

As in China, the Vietnamese government has a 'five-year plan' for long-term national economic development. Installed capacity during the next ten years is expected to

reach 12/15 million spindles (including open-end), which is roughly equivalent to the capacity in Henan Province in China, which is really impressive. The nation's territorial area is narrow and long, and the textile industry is mainly distributed in industrial zones in the capital city of Hanoi, in the north of the country. However, the Vietnam Singapore Industrial Zone (first established in 1996) is located in the central region of Quang Ngai Province and Da Nang, and some spinning mills are in southern Vietnam's Ho Chi Minh City. Vietnam's textile industry has been very dependent on the Chinese market, in that most yarn output is exported direct to China. In recent years, with the development of the domestic economy in Vietnam, the costs of land and labour have been increasing gradually, and spinning mills in the south have been planning to move northward, which is very similar to the route and experience of China's textile industry.

Imports of raw cotton are mainly from the US and Australia (favoured by Chinese investors), along with India and West Africa). Local spinners tend to adhere to a 'hand-to-mouth' buying style, while inventories of foreign-owned mills generally cover one to two months' requirements.

Because of the limitations of single material (pure cotton) and single market (to China), plus the 'less developed' technology in spinning, yarn products in Vietnam are mostly carded/combed 32s/40s and below. Although some large-scale mills have started production of combed 60s/80s, their qualities fluctuate and are not that stable.

Chemical fibre production is rare in Vietnam, except for some enterprises that deal with polyester. Most chemical materials are imported, which is possibly a new potential market for China, given that country's surplus capacity in chemical fibre production. Around eighty percent of the textiles



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produced are for export to China, since Vietnam's domestic demand is weak due to its geographical location and limited population (around 80 million). However, the overall development of the Vietnam textile industry is remarkable, and

the Saigon Textile Fair (held concurrently with the Vietnam Textile & Garment Industry Expo) has been attracting more and more participants in recent years.

With more communication and cooperation between Vietnam and China, the prospects of textile industry cooperation are very promising and diverse. Although political and military conflicts still exist, things have improved significantly from previous years. Besides, the upgrading and strategic transformation of China's textile industry will also bring a great

development opportunity to the textile industry in Vietnam. So, we believe that the outlook for the textile industry in Vietnam will be brighter and more splendid in future.



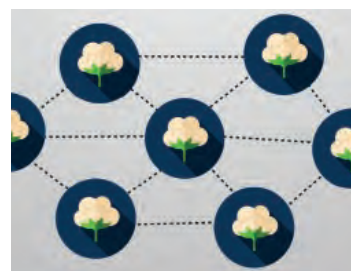
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China's cotton imports in 16/17 and 17/18

BCO (chinacotton.org) and Cotton Outlook

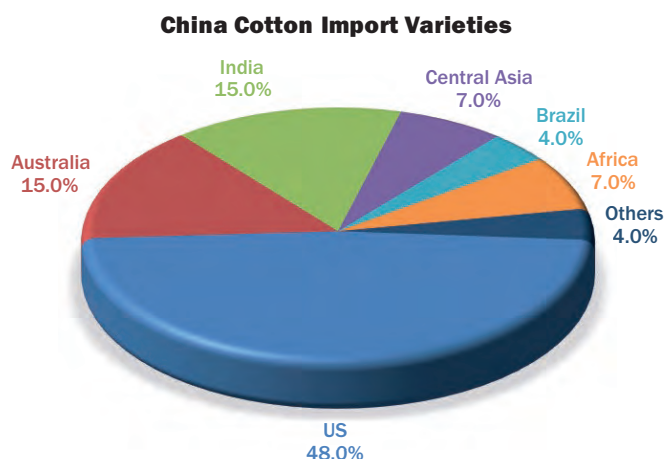
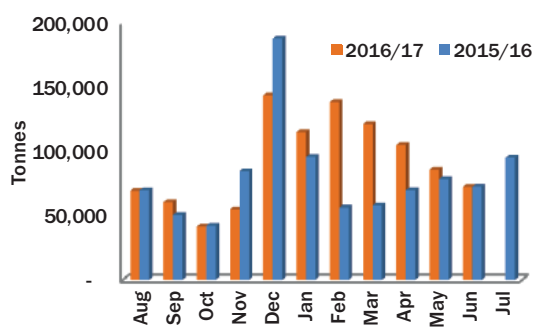
China's cotton imports have shown improvement in 2016/17; the aggregate volume from August 2016 through June 2017 has increased by roughly 16 percent, to over one million tonnes. Meanwhile, we continue to expect imports will be over one million tonnes in the 2017/18 season.

2016/17

1. Imports

China imported 1,006,000 tonnes of cotton in 2016/17 (August 2016 through June 2017), up 16.3 percent year-on-year. Monthly imports are detailed in the accompanying chart:

Monthly import data of China



remain at a similar level as during the previous months, then the total import volume in 2016/17 will be around 1.07/1.08 million tonnes.

According to Customs data, US origins were the main source of imported supply during 2016/17 and accounted for nearly half of the total. Other origins all accounted for less than 20 percent. The proportion of market share was especially noted for Indian cotton, which was once on par with US crops.

2. Customs breakdown

According to Customs data, 44 percent of imported cotton was cleared via Qingdao Customs, 22 percent via other, southern coastal Customs, and smaller proportions via various others.

2017/18

1. Imports

The State Reserve auction will proceed in 2017/18 and the price spread between cotton at home and abroad is expected to run in a relatively narrow



range during the auction programme, owing to the incorporation of international prices (namely the Cotlook A Index) in the mechanism which determines the auction 'base price' each week. Hence, it seems unlikely that the domestic cotton import quotas policy will be eased, and imports will not increase substantially in the next year or so. However, structural demands still exist in the domestic market, and a number of traders will continue to sell their lots on consignment; we predict China's imports in

2017/18 will remain at above one million tonnes.



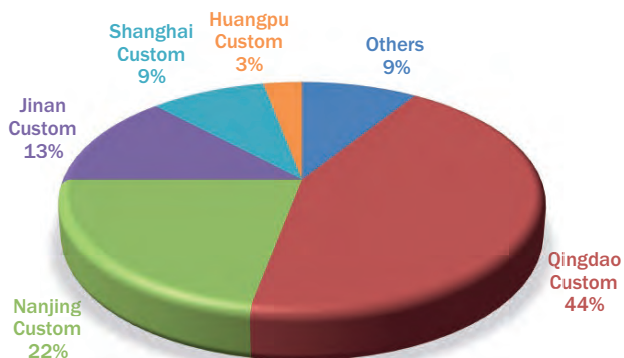
2. Imports breakdown

Given the structural demand from the domestic market, machine-picked high-grades with low contamination, including US and Australian cotton, are the preferred sources. USDA data show that by July 27, 275,000 tonnes of 2017/18 US crop cotton had been committed for export to China, which demonstrates the importance of this source. Other origins may experience difficulty increasing their proportion of exports to China, owing to domestic structural demands, as well as the competitive advantage enjoyed by US cotton of late.

3. Policy anticipation

The State Reserve policy is clearly one of the most significant policies in the global market. However, for the moment, it is not clear what decision the government may take or what the timeframe will be. Currently, the attention of BCO is focused on how much US cotton output may be increased and the resultant potential export pressure in 2017/18, as well as on the consumption, import & export situation for Indian cotton, and the import demands of Pakistan.

Customs Breakdown



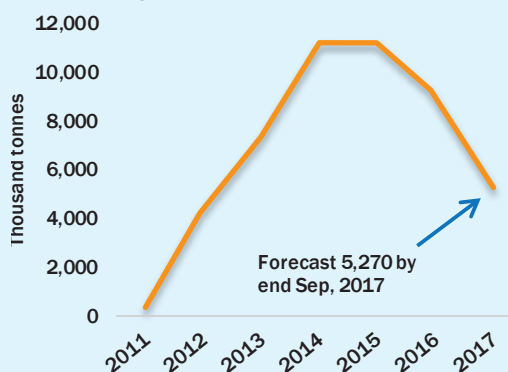
Cotton Outlook's viewpoint

Later data, received after BCO's article was written, show China imports from August 2016 through to the end of July this year (the 2016/17 international statistical season) amounted to 1,905,605 tonnes, or 14 percent more than the figure recorded in 2015/16. Of the total, 46 percent came from the United States, compared with less than 20 percent in 2016/17.

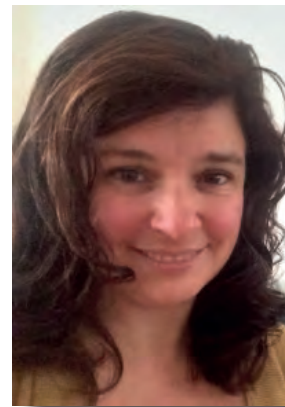
State Reserve stocks as at July 31 stood at slightly less than 6,400,000 tonnes, and other stocks (commercial and industrial) totalled almost 1,800,000, indicating a combined figure of around 8,200,000. By August 31 (the end of China's cotton season), the comparable figures were 5,818,000, 1,718,000 and 7,537,000, respectively. The extended auction campaign (to the end of September) suggests that State Reserve stocks will fall below 5,300,000 tonnes. This amount is presumably approaching a level at which the

government may consider resuming stock rotation, by purchasing Xinjiang 2017/18 crop supplies to augment the quantity (and quality composition) available for next year's auction series. Whether imports will also be taken into the Reserve in 2018 remains in question.

Projected State Reserve stocks

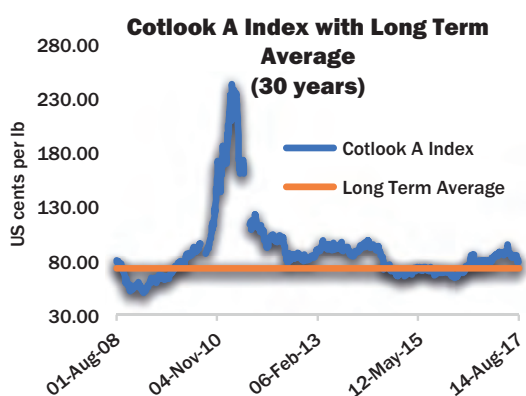


Global cotton trade patterns 2010–2020: a decade of change



Antonia Prescott, Editorial Team, Cotton Outlook

Commodities trading is an absorbing business: in the past, our merchant friends have commented on how easy it is to get caught up in the regular flow of cotton through one particular market. While our attention is focused on the daily deals, whole seasons come and go, global prices rise and fall, bales are shipped in and out of ports all over the world in their millions. So, every now and then, it is useful to pause, look up for a moment and take a longer, wider view of patterns and trends in cotton trading across the globe.



is more than three times the long-term average. Of course, the high price was unsustainable, and soon collapsed under its own weight. Not before stimulating production, though, and setting in train the conditions for an over-supply in the market, as huge numbers of farmers, encouraged by the exceptional returns obtained from the 2010/11 crop, turned their fields over to cotton for the next season. World cotton plantings crossed the threshold of 36 million hectares in 2011/12 – a modern record.

Inevitably, many mills and some downstream consumers of raw cotton had lost money as a result of the previous season's extreme instability and, with fingers burnt, made a decision to move away from cotton into fibres, such as polyester, that benefit from a more stable production process and less volatile prices. Some long-established cotton merchants simply shut up shop. The unpredictability in the cotton market during that period has had a long-lasting and largely negative effect. The cost of a few short-term gains in the market has been an increased mistrust of cotton in some quarters, and a consequent attrition of agents from the sector.

The next significant feature on the landscape is the buying policy implemented by the Chinese government between 2011 and 2014, overlapping with the period of market volatility just discussed. At a point when world prices were close to their historic peak, the state announced a commitment to buy the entire domestic crop, at a pre-determined price. The reasoning seems to have been a desire on the part of the administration to insulate China from fluctuations in world prices by rebuilding reserves that had been depleted in an (ultimately vain) endeavour to preserve a measure of price stability on the local market. Their intention was to create a pool of cotton from which the industry could draw when global prices rose too high for comfort. The policy also satisfied a desire to avoid too great a

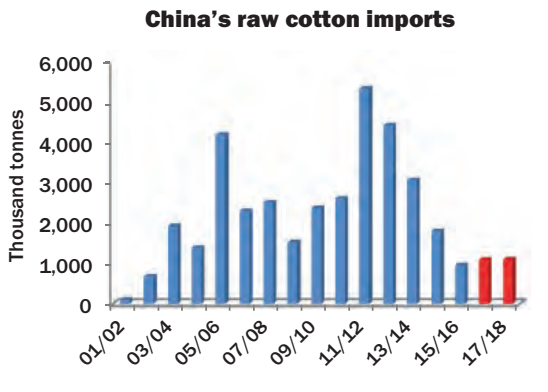
The first major event to appear as we take a retrospective view of the last eight years or so is the extraordinary period during the 2010-11 season, when for reasons that still remain largely unclear, world prices for cotton rose to unprecedented levels. The Cotlook A Index reached a peak of 243.65 cents per lb on March 8, 2011, which



reliance on foreign suppliers to supply domestic demand.

The Chinese government could not have foreseen that, in attempting to mitigate the impact of fluctuating supply and prices in the world market, they would actually leave the domestic cotton spinning sector exposed to them. By the time the policy came to be implemented, global prices had collapsed with the result that the Chinese intervention price was now set at a level far above that in the world market. Amongst several unintended consequences of the buying policy was a sharp loss of international competitiveness on the part of Chinese mills, whose raw cotton replacement

Nevertheless, the policy was maintained for three years. During the three seasons in question (2011/12 to 2013/14), the government also sanctioned imports on a scale never before seen. Chinese imports reached a peak in 2011/12 of over 5.3 million tonnes, and were in excess of 4.4 million the following season. The effect of such a policy from the largest import market in the world was, of course, hugely significant. In a period of massive global over-production, when prices would normally have been expected not just to fall, but to crash, much of the surplus stock was effectively absorbed by the China National Cotton Reserves Corporation. This had the effect of supporting the global market to some extent, but also left China with huge stockpiles of cotton (an estimated 11 million tonnes by the start of 2014/15), as the rate of acquisition far outstripped the pace of consumption.



costs were well above those enjoyed by their counterparts in the rest of the world. Cotton yarn imports increased dramatically.

Clearly, this accumulation of stocks was unsustainable, and so the next big shift came in the form of a revised strategy from a fairly new Chinese administration in 2014/15, when the policy of open-ended state procurement of cotton that had been in place for the previous three seasons was brought to an end. The main focus of support for domestic production was concentrated in Xinjiang, with other areas left to languish under a policy of benign neglect. Import quotas were restricted. The process of disposing of accumulated stocks began.

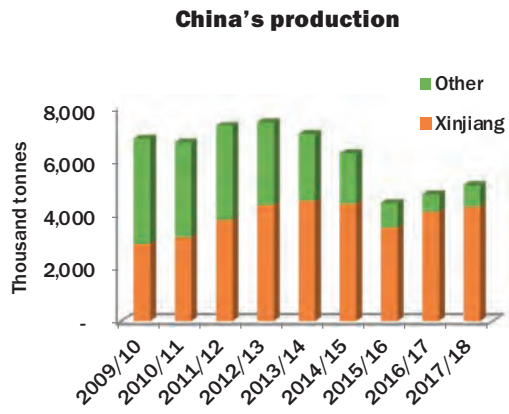
In this new phase, which brings us up to date, the Chinese government's intention appears to have

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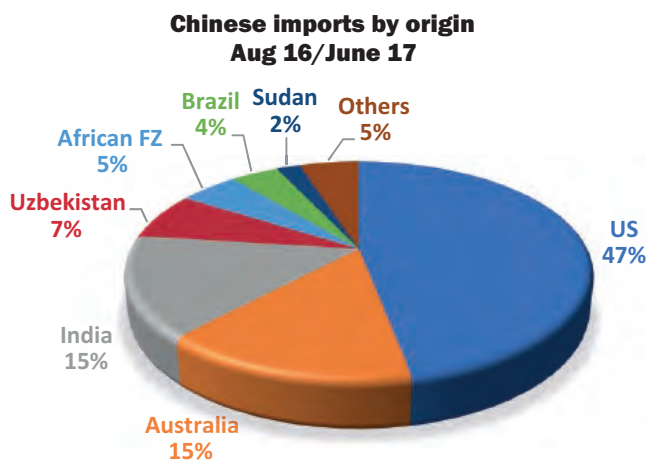
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been to maintain production at no less than five million tonnes a year, while annual consumption has been rising steadily to about eight million tonnes. Meanwhile, world and Chinese prices have converged as a consequence of China restructuring its system of support under the target price arrangements in Xinjiang. With imports pegged at around one million tonnes – close to the level required by the WTO as part of China's accession agreement – the difference between production and imports on the one hand, and consumption on the other, has been made up through sales from State Reserves via the daily auctions.

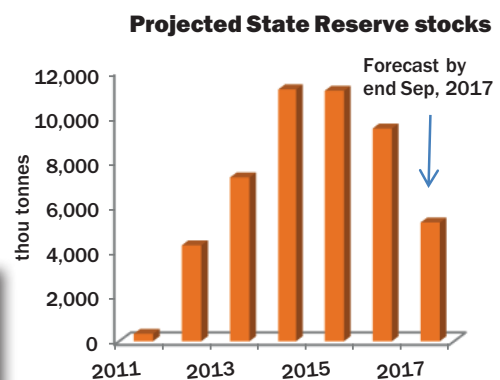


The impact of reduced imports into China on major exporting countries was immediate and severe, with the total cut by more than a million tonnes between 2014 and 2015, plus another reduction of about 844,000 by 2016. Imports from India fell by almost 90 percent over the two-season period, and from USA and Australia by 70 percent and 60 percent, respectively. There are currently some significant signs of recovery from US and Indian exporters into China for the 2016/17 season, but these figures are still well down on previous levels and the gains come at the detriment of other markets – most notably Australia, which is down further still.

Of course, while China has restricted receipts of cotton over the last three years, other import markets have not stood still. Bangladesh and Vietnam have been growing their import numbers steadily to the point where they now outrank China

in terms of import volumes. Rising demand from these two markets has helped to sustain world prices, which have also been supported by the fact that world production in 2015/16 and 2016/17 has been toward the lower end of the range of output in recent seasons.

Meanwhile, within China, the State Reserve is running down stocks at an impressive rate. From their peak at over 11 million tonnes in 2014-15, they declined to around 8.25 million towards the end of 2016, and are projected to end the 2017 auction series at below 5.3 million. Still imports remain restricted. So, the next phase in the world market's evolution depends on the answers to two related questions: when will the Chinese administration judge that stocks have been sufficiently reduced, such that they can be maintained at a prudent reserve level; and when will import restrictions be relaxed once more?



While the cotton world waits for policy announcements from China, we can only speculate about the answers; however, some observers do predict a return to greater import numbers at some point in the 2018/19 season. The impact of that decision on global trade patterns promises to be far reaching. Given China's apparent structural deficit of three million tonnes, most commentators predict that imports will rise from their current level by around two million tonnes per annum in the coming years. How an increased uptake of foreign cotton is likely to be distributed across the various major exporting countries is hard to forecast. As always, price will be a major factor, and there is likely to be an additional emphasis on supplies of machine-picked, 'contamination-free' cottons that meet the requirements of today's high-tech spinning industry.

Meanwhile, as China has been running down its own stocks, current projections of world production in 2017/18 suggest that an abundance of cotton will have accumulated in the rest of the world by the end of the season. World prices may thus come under further pressure as the surplus outside China – over 2.4 million tonnes, according to our latest estimates – is absorbed, before China relaxes its import policy once more. That said, if and when China does sanction imports on the anticipated scale, the further impact on the global market is likely to be significant. At that point, we may be on the threshold of a new phase in the world market's evolution.





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China: the industry's westward move and future outlook



Horace Wang, Manager, China Top

At the beginning of 2015/16, people were bearish about Chinese consumption prospects. Estimates of the national total fell to around 6.5 to 6.8 million metric tonnes. Despite the policy already in place encouraging spinners to expand into Xinjiang, pundits remained unconvinced in the face of a number of uncertainties: would the policy work; would the labour force in Xinjiang be up to the task; although relocating spinners to Xinjiang would bring them closer to the raw cotton supply, how would their distance from downstream markets work; would Xinjiang quality, which had been deteriorating, be improved (some tongue-in-cheek comments alluded to the crop having been grown for the State Reserve, rather than for consumption)?

None of these uncertainties are easily dismissed and some of them persist to this day. Nevertheless, during the past two years, sentiment has shifted to an almost unanimous appreciation of the benefits of expanding into Xinjiang, which has doubled its own consumption within the abovementioned timeframe, and thereby helped reinforce China's position as the No.1 cotton consumer in the world, restoring the annual figure to above eight million tonnes.

The extent to which consumption in Xinjiang is rising is difficult to illustrate simply by listing the investment plans of the top mills, since some of these might not come to fruition and others take time to implement before reaching full capacity. In short, this is work in progress. Having said that, at the start of 2015/16, Xinjiang could only produce about 600,000 tonnes of yarn (cotton and viscose). During that season, Xinjiang mills were thought to have consumed

inventories of 205,000 tonnes plus 660,000 from the region's 2015/16 crop and about 50,000 tonnes taken up at State Reserve auctions. This assumption is supported by the fact that only 2.87 million tonnes were moved eastward during the period from October 2015 through to September 2016. The upward momentum in the region's consumption has continued since. From an increased output during 2016/17 of 4.05 million tonnes (520,000 more than the season before), shipments eastward have been only a tad higher (2.92 vs 2.87 million tonnes). As the end-of-season price prevailing in Xinjiang is higher than that in the East, it seems safe to say that consumption growth in the region has persisted (rather than that cotton has been hoarded). If that assumption is correct, the past 12 months' consumption should be close to 1.2 million tonnes. A better understanding of our calculation and reasoning might be gained from the table on the next page.

Many observers suggest that the rate at which equipment is being installed in Xinjiang might already have peaked, and that the pace of growth of the past 24 months is thus unsustainable. However, since spinning in Xinjiang definitely provides a positive margin nowadays, and the equipment operation needs a window of three to six months to reach its full potential, we tend to believe that Xinjiang has a fair chance of consuming 1.5 million tonnes in the next 12 months and that the annual figure might eventually reach two million before stabilising.

Should our prediction materialise, it will surely have a profound influence on the pricing mechanism of Xinjiang cotton. On the supply side, there is pressure as a result of limited water resources and land, so the opportunity for significant further expansion in output above the 4.5 million tonnes mark projected for 2017/18 would seem not to





Period	Months	Xinjiang commercial beginning stocks	Xinjiang production	Transport out of Xinjiang	Possible purchase from Eastern or Reserve	Xinjing commercial ending stocks	Xinjiang consumption during the period
(tonnes)							
Oct 15 - Sep 16	12	290,000	3,530,000	2,870,000	50,000	85,000	915,000
Oct 16 - June 17	9	85,000	4,050,000	2,840,000	-	470,000	825,000
Oct 16 - Sep 17	12	85,000	4,050,000	2,920,000	80,000	100,000	1,195,000

exist. Farmers have the upper hand already, given that ginning capacity is more than twice that of production, so ginners have to pay premiums in order to secure seed cotton. On the consumption side, when the full local potential is reached it will account for perhaps 35 percent to 45 percent of total Xinjiang production, which would significantly reduce the region's surplus (formerly equivalent to as much as 85 percent of output). The effect might be to create a shift in cotton used outside Xinjiang of about one million tonnes to imports or reserve supplies (which most likely will still come from imports further down the road). The possible consequences are outlined below.

1) Xinjiang cotton may increase in price.

Take India and Uzbekistan as analogies. When both origins started to have significantly lower exportable surpluses, owing to growth in domestic consumption, their basis levels firmed significantly and their bargaining power in export markets increased dramatically. We suggest that the crucial factor is the proportion of output available for export, rather than the absolute volume, as both origins are still among the top five producers.

Therefore, we are inclined to believe that Xinjiang's basis will tend firmer.

2) Forward selling will become more likely.

More forward sales are foreseeable, making use of ZCE futures and basis trading.

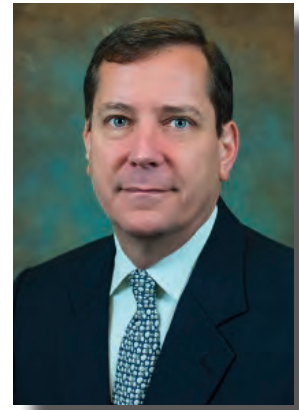
As Xinjiang, especially the PCC (military group), improves the quality of its cotton and the share of machine-picked cotton increases, the fibre is gradually gaining recognition as a substitute for US/ Brazilian and even Australian machine-picked lots, especially for bleaching yarn. Such a change should create the likelihood of forward sales, as mills need to lock down certain qualities in advance, so as to ensure uninterrupted production. The involvement of several international merchants and prominent domestic traders is a growing tide that will result in more and more Xinjiang cotton being traded on a 'basis/on-call' fashion. With ZCE changing their standard contract from T3128B landed eastern warehouses into T3128B ex-Xinjiang warehouse from this autumn onward, we believe an increasing number of large, reputable mills and merchants will find the forward basis trading very beneficial and that this will become increasingly popular.

3) Chinese Eastern mills will seek import cotton more actively.

The big picture changes a lot in the East as well. Previously, of a total consumption of 6.5-7 million tonnes, half could be sourced from Xinjiang. The changes afoot will mean a deficit of about three million tonnes that cannot be supplied – from either Xinjiang or eastern crops. As a result, spinners' needs for imports will increase and they will have to plan such purchases earlier and in a more systematic fashion.

	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
India (thousand tonnes)										
Production	23,300	24,500	27,200	29,000	28,500	31,000	29,500	26,400	27,000	29,000
Exports	2,360	6,550	5,000	11,080	7,761	9,261	4,199	5,764	4,300	4,200
Domestic consumption	17,750	19,750	20,550	19,450	20,750	22,750	24,500	24,250	24,000	24,750
Export/production	10.13%	26.73%	18.38%	38.21%	27.23%	29.87%	14.23%	21.83%	15.93%	14.48%
<i>In the past 10 seasons, the Indian basis strengthened from 200/400 on to 600/1000 on.</i>										
Uzbekistan (thousand tonnes)										
Production	4,600	3,900	4,200	4,000	4,600	4,100	3,900	3,800	3,675	3,700
Exports	3,000	3,800	2,650	2,500	3,200	2,700	2,450	2,500	1,500	1,700
Domestic consumption	1,000	1,100	1,250	1,350	1,450	1,500	1,550	1,600	1,700	1,750
Export/production	65.22%	97.44%	63.10%	62.50%	69.57%	65.85%	62.82%	65.79%	40.82%	45.95%
<i>In the past 10 seasons, the Uzbekistan basis strengthened from 800/1200 on to 1200/1600 on.</i>										

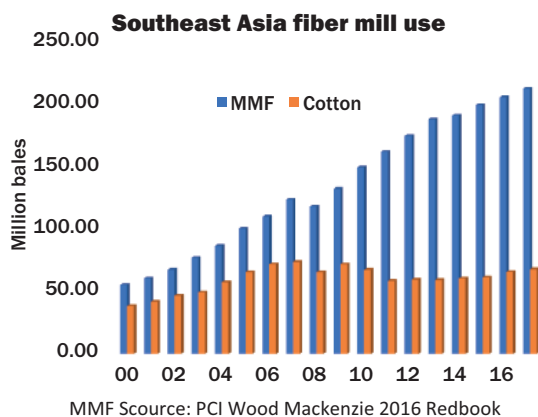
Changing trading patterns in Southeast Asia



William R. Bettendorf, Director, Supply Chain Marketing & Director (Southeast & South Asia), Cotton Council International



The growth in Southeast Asia's textile and garment production has exceeded the expectations of many in the global cotton industry. The combined attractions of investment incentives, a very ample and capable workforce, competitive wages and growing investments in improving infrastructure such as industrial parks and port facilities, mean that Southeast Asia has become the shining star of the global textile and garment industries.



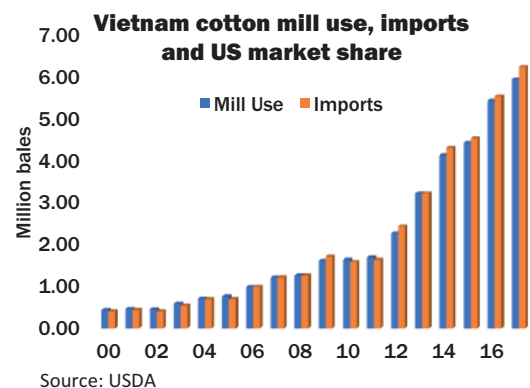
is much more positive. Led by the tigers in the cotton textile industry, Vietnam is breaking new ground thanks to its proactive position. The growth in the yarn and garment production sectors is unprecedented. Recognizing the power of the textile industry to fuel its growing industrialization, Vietnam's government has made massive investments in the sector.

Cotton spinning has grown exponentially, thanks especially to foreign investment from China and Korea. The spinning industry has grown by over 500 percent since 2000. Current cotton consumption stands at almost 6 million bales compared to under 500,000 bales in 2000.

Strict environmental controls have limited the interest to invest in the textile sector in Vietnam. However, there are new projects in the pipeline to develop this critical link in the cotton-to-garment supply chain. The country has also attracted investment, especially from China, to develop impressive cutting-edge industrial parks, some dedicated to the textile and garment sectors, in areas such as Nam Dinh. These contain everything

Unfortunately for those of us in the cotton industry, however, most of that growth is attributed to the synthetic fiber industry and not cotton. Nevertheless, despite continued growth in the synthetic fibers used, cotton continues to regain some of the high consumption levels seen prior to the cotton price spike in 2011.

Taking a closer look at cotton specifically, the news



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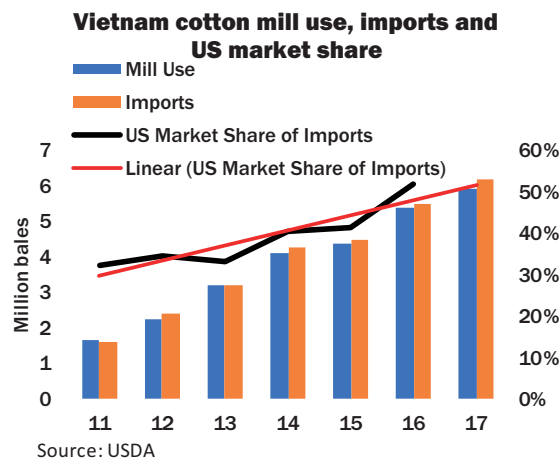
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needed for a factory town to thrive, such as improved highways and ports, housing, schools, hospitals, entertainment and athletic facilities, factory areas, transportation infrastructure, power and waste water treatment facilities.

Despite its weaker fabric manufacturing segment, the garment industry in Vietnam now rivals China and is expected to continue to grow; furthermore, the outlook for cotton spinning continues to be positive (despite the failure of the TPP) which is an acknowledgement of the power of Vietnamese garment exports and growing consumer markets.

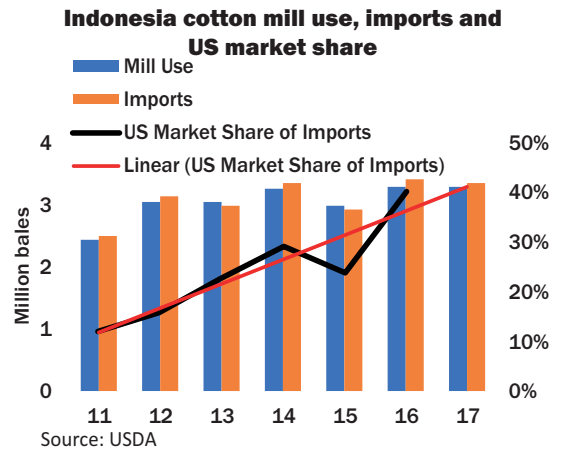
Thankfully, cotton continues to be the pillar of the yarn spinning industry in Vietnam, despite recent shifts to blended yarns and synthetics. Quality requirements have also shifted, as we can see by the rapid growth in the quantity of U.S. cotton used by mills in Vietnam over the past five years. Given the continued strengthening of the Vietnamese spinning sector, Cotton Council International (CCI) is very optimistic about the prospects for the continued popularity of U.S.-grown cotton in Vietnam.



Quality requirements from selective customers help to support the popularity of U.S. cotton with mills. Contamination-free cottons are increasingly in demand, which narrows the field of options immensely. Since every U.S. bale is HVI classed, confidence is inspired among customers who need reliability in terms of quality.

The second strongest textile economy in Southeast Asia is Indonesia. Since 2000, Indonesia has added about a million bales of cotton to its annual mill consumption, to reach approximately 3.3 million bales today. Thanks to a strong domestic industry and offshore investments in yarn and textile production, Indonesian cotton consumption remains stable. It could increase dramatically if the current government succeeds in stemming illegal textile imports; however, the

thousands of islands and large land mass pose quite a challenge for the authorities in this regard. If successful, though, Indonesian textile production could easily see double-digit growth, given its rising level of exports and expanding middle class, which is the largest in the region – approaching 262 million people, according to the World Bank.



In addition, the Indonesians have been very innovative in their support for cotton mills, improving and developing infrastructure. For example, in 2016 the industry and government launched a new bonded warehouse about an hour's drive from Jakarta, in Cikarang. This "dry port" is a modern warehouse facility dedicated to cotton. The idea is to have an ample supply of cotton available to the mills who can then fill short-term needs quickly. While this will not solve the problem of long transit times, nor replace the warehouse facilities found in Malaysia, the Cikarang facility reports that their fees are more competitive than in Malaysia, and that they offer greater potential for faster transactions as mills are located within a day's drive of the facility. Also, the road and rail networks are scheduled for improvement in order to facilitate the flow of goods from the industrial zones to the ports.

Cotton is set to remain very important to the Indonesian textile industry, and as the industry adjusts itself to compete on a global scale, spinners are paying much greater attention to producing higher quality yarn for their customers. Thus, the U.S. share of cotton imports has grown significantly over the past five years – despite the onslaught of price-driven competition from other countries. The Indonesian mills cannot compete on price alone, so their focus is turning to higher and higher quality merchandise especially for the export markets.

COTTON USA's marketing support to the textile industry

The U.S. cotton industry recognizes the significance and importance of the Indonesian and Vietnamese textile industries to its own operations. For this reason, CCI has sharpened its focus on these markets in an effort to provide the local industries with more information and marketing support so as to reinforce their textile supply chains. On the technical side, CCI and Cotton Incorporated have placed more resources in these markets and are investing in more education for the spinning community.

Recognizing the importance of the trade and growing consumer markets, CCI will launch two more of its successful "COTTON DAY" events in Indonesia and Vietnam on September 6 and 12, 2017, and will also begin to support local mills by investing in retail sales promotions. COTTON DAY started in Japan about twenty years ago, and since then has spread to key U.S. cotton markets including Korea,



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production rather than replace it. The growing population in China will see demand for textiles and other goods maintained for some time to come. China's One Belt One Road policy, which supports the development of infrastructure outside China to "feed" China in the future, continues to excite the global cotton textile industry, especially in those countries bordering China, such as Vietnam to the south and Pakistan to the north.

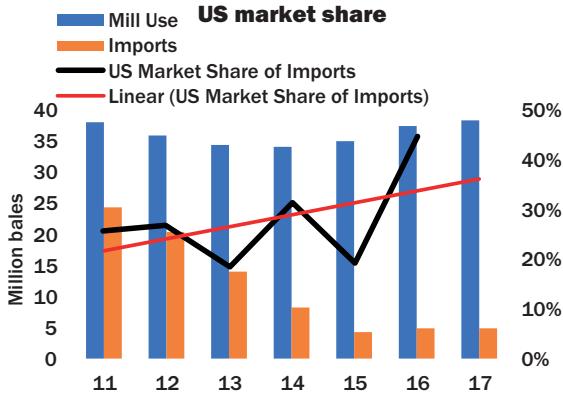
That said, the Chinese textile industry remains firmly rooted and critical to the global cotton trade. Compared to an all-time-high mill use of cotton of 51 million bales in 2007, Chinese cotton consumption appears to be stabilizing at approximately 38 million bales per year.

Chinese mills are also demanding higher quality. The chart above shows a slight recovery in consumption to the level it was at in 2011, although imports have decreased due to the operations of the State Reserve. However, even in the face of lower imports, the share of U.S. cotton has been growing steadily, showing the support for U.S. cotton by mills. Discussions with our COTTON USA-licensed mills in offshore markets, which supply Chinese fabric and garment manufacturers, also confirm that demand for COTTON USA qualified yarns and fabrics is high.

Taiwan, Thailand, Bangladesh and China. This is an invitation-only trade event that brings together the entire cotton supply chain in each market. The day starts with a series of presentations relevant to the industry and closes with a networking event usually punctuated by a fashion show co-sponsored by textile mills and local brands. COTTON DAY is also used as the launchpad event to kick off a season of retail sales promotions featuring the COTTON USA brand hangtag on quality cotton products.

The influence of China in the Southeast Asian region continues to be omnipresent. Much of the investment has been Chinese. Chinese companies are opening new facilities in Southeast Asia and these factories tend to supplement domestic

China cotton mill use, imports and US market share



Source: USDA

Conclusion

The U.S. Cotton industry continues to be committed to supporting our international markets with the best quality cotton fiber available today. The continued investment to improve the quality of seed, through enhanced high-tech production methods that employ the most sustainable practices in the world, is proof of this. Responsible production combined with support for our customers via trade promotion events, such as the biennial Sourcing USA Summit, the annual COTTON USA Sourcing Fair and COTTON DAY events, demonstrate our appreciation and commitment to our loyal customers. It is through this type of commitment that U.S. cotton has become known as "The Cotton the World Trusts."



The changing face of Australian cotton exports



David Dowling and Mick Allan, *The Australian Cottongrower*

Forty years ago, the fledgling Australian cotton industry was faced with a straightforward, albeit difficult, marketing challenge. The high quality product that Australian farmers grew in most years was similar, if not quite equal in terms of quality, to the dominant Californian SJV cotton. And the biggest customer by far in the higher end of the market was Japan.

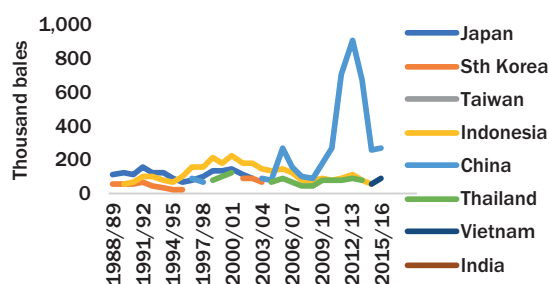
So, one major customer and one major competitor. Australian marketers wooed the Japanese buyers and made the most of their own natural advantages of proximity to Asia and a southern hemisphere production period. They made great inroads into this important market.

But in 2017, Japan retains just a fraction of its former spinning capacity. And agriculture in California's San Joaquin valley is now dominated by higher value tree crops and dairies, with cotton now a minor crop at best. The nature of Australian exports has had to shift dramatically as our biggest customers have changed, and new production competition has emerged, while other competitors faltered. It has been an interesting journey to get to where we are now, and a constantly changing one.

Sometimes the transformations have been gradual, but there have also been some quite dramatic swings in a volatile market.

Figure 1 shows the changes in the composition of Australia's top three export markets over the years. For a long while, Japan had total dominance before being overtaken by Indonesia as the most important market. Then, in the early years of this century, China exerted its dominance in the world cotton trade. For Australia,

Figure 1. Australian export markets



China has retained that position as the biggest market, although it has retreated somewhat from its previous pre-eminence in the global context.

At the 2016 Australian Cotton Conference, Namoi Cotton's Eimear McDonagh and the Australian Cotton Shippers Association Chairman Tony Geitz looked at the change in cotton export markets, particularly over the past decade. Much of the following material is drawn from those presentations.

"China's influence has been extensive," said Eimear, "not just in terms of their purchasing demand, but also of their yarn import policy, which has disrupted what we have known as the normal textile supply chain, to the extent that we are unlikely to see these trade flows revert to past practice again."

China imports

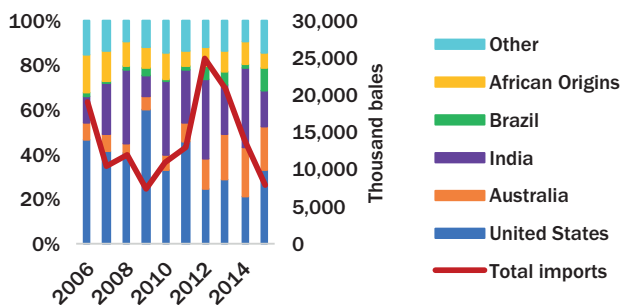
While Chinese imports have fallen considerably over the past few years, Australia has held its market share (Figure 2). Brazil is also starting to pick up market share, largely at the expense of India. But while Chinese imports of raw cotton are falling, their





Figure 2.

Origin of Chinese imports



imports of yarn are increasing, mainly from India and Vietnam.

“As the stockpile is eroded, China should become a large net importer again within the next three or four years,” Tony Geitz said.

Japan

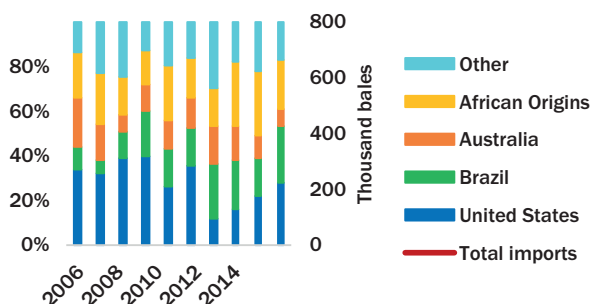
So, what of Japan, which for many years provided the backbone of the Australian cotton export industry? The decline of the Japanese spinning industry has seen raw cotton imports fall to around 300,000 bales per year, of which Australia contributes a diminishing share.

But Japan is still a major consumer of cotton end products, so the focus of Japanese spinners has shifted in recent years to investment in offshore production in areas such as Indonesia, Thailand, Brazil, China and Vietnam.

Indonesia

The textile and garment industry is an important contributor to Indonesia’s economy, serving as a large source of employment and export earnings. Indonesia also has a strong domestic market (258 million people).

Figure 3. **Origin of Indonesian imports**



Manufacturing in general (and the textile and clothing industry in particular) has been a driving force of Indonesia’s development and continues to represent a significant factor in the economy. It now accounts for 25 per cent of GDP (US\$525 billion).

In the 1990s Indonesia overtook Japan as Australia’s biggest export market and still retains an important position today despite difficulties such as rising costs and strong competition from man-made fibres and other spinners.

Between 2014 and 2015, labour costs rose by 32 per cent and electricity costs by a staggering 64.7 per cent in some cases.

Australia’s share of the Indonesian market has fluctuated over the past decade but there has been a general, though significant reduction, to a point where Australia contributed only eight per cent of Indonesia’s raw cotton imports in 2015 (see Figure 3).

Some of the reasons for this decline include:

- ◊ booming Chinese demand attracting more and more Australian cotton over the period;
- ◊ the fluctuating nature of Australian cotton quality resulting in spinners looking elsewhere for supplies in some years;
- ◊ intense competition from US and Brazilian growths eroding Australian market share, especially at the price premiums traditionally expected for Australian cotton.

Vietnam

One of the most interesting trends in recent years has been the emergence of Vietnam as Australia’s second biggest destination for raw cotton exports, now surpassing Indonesia. Total Vietnamese imports have boomed over the past few years, spurred on by investment from international spinners attracted by low costs and the country’s attractive investment environment. It is important to note that the vast majority of cotton sold for shipment to Vietnam is sold to Chinese entities that have established spinning mills outside China in

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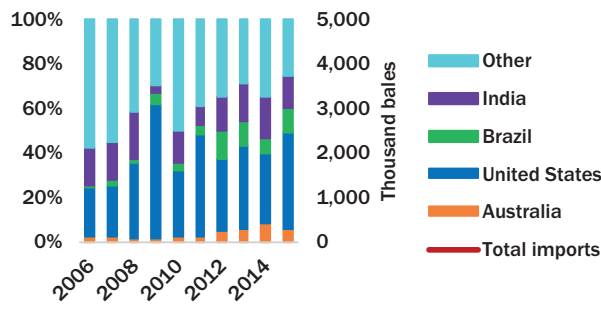
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Figure 4. Origin of Vietnam imports



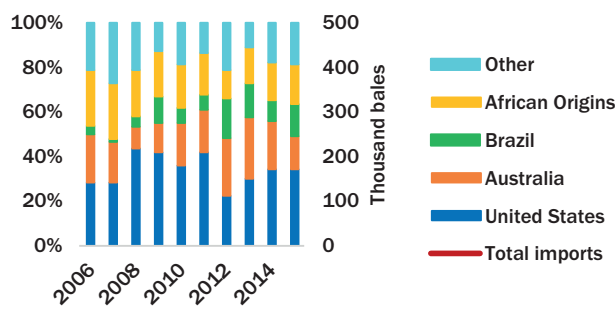
order to take advantage of the absence of quotas and of the fact that no import tax applies to yarn moving back into China.

Australian exporters were late to get to this particular party, but they have managed to maintain, or increase, their share of this rapidly expanding market in the past few years (see Figure 4). However, with a current market share of well under 10 per cent, there is room for considerable expansion in the future.

Thailand

The Thai spinning sector has struggled in recent years to compete with the emergence of other low-cost producers in the Asian region, although recently the overall decline has been stemmed to a certain degree by significant investment in upgraded spinning machinery. Thailand remains an important market for Australian cotton, but it is highly price sensitive and Australian market share can be expected to fluctuate considerably (Figure 5).

Figure 5. Origin of Thai imports



Other markets

Of the other Asian markets, Bangladesh is currently the world's largest importer of cotton, and is becoming an increasingly important destination for Australian exports. Meanwhile, India has emerged as a significant destination when their own crop size is reduced, although their particular demand is for longer, stronger fibres.

South Korea has been a reliable and consistent user of Australian cotton for many years, but Australian market share fluctuates and has been generally reduced in this price-sensitive market.

Overall, Australian raw cotton exports now cover a wider range of destinations than they did in the past. Previously,

our exports were totally dominated by Japan, then Indonesia and then China. And while China retains a pre-eminent position, there is now a healthy spread of markets to sell into in Asia.

The future of Australian cotton in traditional markets

At the 2016 conference, Eimear McDonagh stressed the need to rebuild Australia's market share in traditional export markets such as Indonesia, Thailand, South Korea and Japan, as well as taking advantage of expanding markets such as China, Vietnam and Bangladesh. These traditional markets are important for a number of reasons:

- ◇ the countries are all net importers of cotton – they have no domestic supply, so they don't experience the destabilizing impact of a volatile domestic crop in the way that China and India do;
- ◇ they tend to be strong forward buyers, buying one to two years forward and for multiple months. Merchants are thus able to take risk from growers in advance;
- ◇ they understand Australian quality and value the long-term relationships that have been established.

So, how does Australia increase its market share?

Eimear also stressed the importance of protecting and increasing Australian market share in all Asian markets by:

- ◇ continuing to promote the benefits of Australian cotton for medium and high count yarn spinners;
- ◇ showing a value proposition and being priced competitively with the US and Brazil;
- ◇ consistently improving our quality with longer, stronger fibres. Then our 'contamination-free' cotton can become a partial substitute for ELS/Pima cotton, while mills can reduce their costs by blending our longer staple cotton;
- ◇ realising that blended yarns are here to stay – the 'active-wear' lifestyle is upon us, and it is better to have blended yarn than 100 per cent polyester;
- ◇ maximising our advantage of counter-cyclical availability – Australia is perfectly positioned to meet Asian mills' demand from April-October and sometimes offers the only high-grade cotton available during this period;
- ◇ maintaining fast delivery times. We have the quickest supply chain to Asian markets – 12 days for Jakarta, 15 days for Bangkok and Korea;
- ◇ enhancing sustainability and traceability – today, retailers lead the demand for particular fabrics, and, as well as cost, their focus is on the sustainability and traceability of raw materials. The good news for Australia is that we produce the most sustainable cotton on the planet and we have the ability to provide traceability, so we can use this to our significant advantage.



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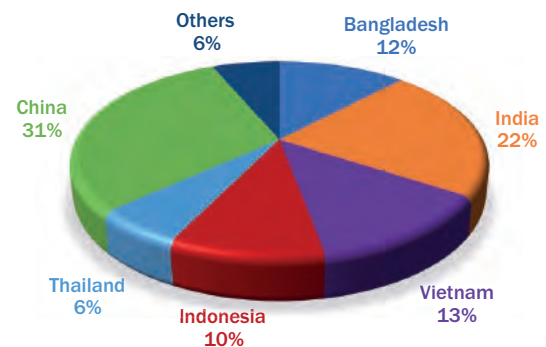
Cliff White, Senior Vice Chairman, Australian Cotton Shippers Association

Holding the annual International Cotton Association event in Asia is testament to the status of the Asian region in the global cotton market. It provides the opportunity to highlight the many important countries that make up this cotton producing and consuming territory, and Australia's position within the strategic area.

It is hard to overstate the importance of the role that Asia and the Subcontinent will play in the cotton industry for the foreseeable future. Just take a quick look at any supply and demand numbers and you will notice that close to 80 percent of the world's cotton consumption is within this region. But it's not just consumption – we also have production to consider, and Australia's position as a major supplier of premium cotton is unique. Essentially, Australia has the world's major production and consuming region on its doorstep and is ideally located to service all of these markets.

Australia exports all of its cotton to various destinations; however, the range of destinations has changed dramatically over the years. Some changes have been positive, some negative, but what is very clear is that the direction of Australian cotton has kept moving in line with those shifts. Over the years, we have witnessed huge swings in export market destinations due to a number of factors, but a driving force in the majority of these changes has been cost, and the historical tendency of cotton spinning to move to the lowest-cost location looks set to continue. A dramatic change in export destinations provides the industry with tremendous opportunity, but it also presents significant market challenges, as we have seen lately in consequence of market developments in China.

Destinations for Australian Cotton in 2016



A succession of major markets have lost their relevance to the Australian cotton industry over the last few years. In the 1980s, the Japanese market helped get Australian cotton established and was ably supported by the likes of South Korea and Taiwan as a north Asia focus. When rising costs in those countries began to reduce consumption, a new number one for Australian cotton emerged in the form of Indonesia. Lately, the focus has been on China

Top 5 comparison	
2012	
China	71%
Indonesia	8%
Thailand	6%
Korea	5%
Bangladesh	3%
2002	
Indonesia	30%
Korea	16%
Japan	16%
Thailand	15%
China	4%

as Australia's principal market but the interesting fact is that in each case the primary market – be that Japan, Indonesia or China – has taken over 50 percent of production. The question the Australian industry crystal ball needs to answer right now is: how long will China remain in this position? And, following on from this: which country could assume the position at some point in the future?



Australian merchants now find themselves needing to re-establish Australian cotton in previously traditional markets such as Indonesia and Thailand, where considerable market share has been lost, while at the same time developing new markets in Vietnam and Bangladesh. Historically, the Australian industry has always managed to achieve this adaptability and the quality of our cotton should mean that we can carry on this performance.

There is no doubt that we all operate in an ever-changing market, and from an Australian perspective we have seen the evolution of quality in the premium area. First it was California SJV GC 21-35 that the industry strove to equal. We eclipsed this target and Australian cotton came to be regarded as the benchmark for high-grade cotton. More recently, Australia has been challenged by the improved qualities of Texas and Brazil. Indeed, the three growths of Australia, USA and Brazil now dominate the market for machine-picked, 'contamination-free' cotton and competition amongst the three is extremely fierce.

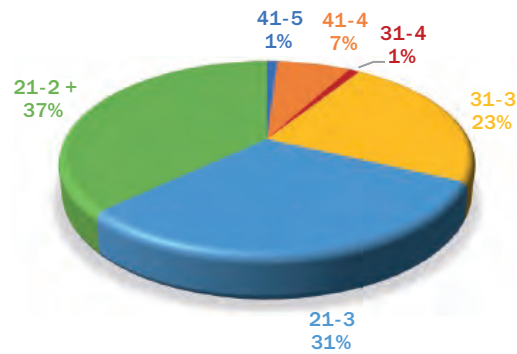
Australia has proven that it is the master of quality evolution. Australian cotton has evolved over time, and while our generic quality today can best be described as Strict Middling 1-5/32" or 37 staple 3.8-4.9 Micronaire and 29GPT minimum, it is not that long ago that our base export grade was Strict Middling 1-3/32" G5 90,000PSI rather than today's GPT. Longer and stronger cotton is the theme.

So, what are the biggest challenges to the Australian cotton industry today? Without question, the unpredictability of our production levels has to be at the top of the list; this has been exemplified in recent seasons as production has swung from above 5 million bales down to 2.5 million bales. This fluctuation of over 2.5 million bales is greater in size than the entire Australian crop just a few short years ago, and we don't need to remind anyone that droughts come around on a far too frequent basis in Australia. The Australian industry was fortunate, in that when we produced our 4-5 million bale crops China was building up its reserve stocks; but what happens if we again produce 5 million bales – where would that cotton go? Marketing a crop of that size in the current conditions would indeed be a huge challenge. It is reasonable to assume that, barring any major calamity, Australian production levels should be comfortably over one million bales each season but we still return to the questions of variability in production and of the planning required to market the crop.

We do have a product that ticks all the boxes, and the spinners' ever-increasing requirements highlight the importance of quality; however, price and competition from MMF also affect the thinking of those spinners. Australia is producing a high-quality product and we are rightly very proud of our achievements in terms of ever-improving quality and yields, but what is the target we are trying to hit? Is Australia producing a product that the buyers want? After all, global production and consumption are spread over a variety of qualities, and the segment we wish to be in represents only a small portion of the global market. We could not place all of our cotton in the fine cotton segment, which represents 10% or less of global consumption, so that means we have to drop into the high/medium qualities,

which is perhaps the most competitive area of all. It is therefore imperative that Australian quality improvement continues, and in this area we need to be consistently producing 32GPT to match our 38 / 39 / 40 staples.

**Australian cotton grade
2016 season**



We cannot talk about quality without thinking about price, and in particular the Australian basis and its level relative to those of other growths. Australia needs to be competitive and we need to move our cotton. Looking at futures prices over the longer term, it's clear that most of the time prices remain relatively stable within a marketing year (with a few exceptions in recent years), so it really comes down to basis levels. The Australian industry learnt a painful lesson when basis levels reached truly crazy heights for the 2014 and 2015 crops, and no doubt we all believed the hype about us having a product that the market would literally pay any price for. Well, we certainly found out that this was not the case as our customers switched to other growths. Australian merchants visiting spinners during this time were told very clearly, "We really like your cotton but it is simply too expensive." And that brings me back to the question of how we would market a 5-million-bale crop. Quite simply, we have to be more price competitive and that has already translated into lower basis levels. All basis levels have eased over the past twelve months, but Australia's requirement has been more pressing due to the fact that we were so far out of line with our competitors. Today, we are far more in line with our major competitors of USA and Brazil.

In addition to the individual companies promoting Australian cotton, our trade body travels to all the main consuming markets, and its membership consists of all the major global cotton players. Formed in the 1980s, the Australian Cotton Shippers Association (ACSA) has witnessed all the dramatic changes in both our own industry and the global industry. We do hope that those of you attending ICA Singapore will take the time to hear the latest and greatest about Australian cotton during our "G'day Singapore" presentation on the morning of Thursday October 12.

In summary, Australia does have a premium product and while it will still be all about quality, sustainability, traceability and reliability, the real challenges are being able to constantly adapt to changing circumstances and being able to position Australian cotton at the forefront of the premium market.



Regaining cotton's edge in the world market

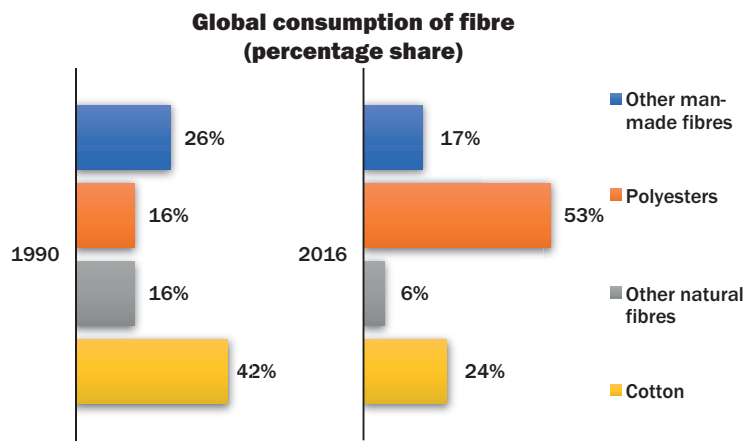


I.J. Dhuria, Director (Materials), Vardhman Textiles Ltd.

In almost all conferences and meetings, stakeholders in the textile value chain talk about the dominance of man-made fibres and the shrinking market share of cotton. This is amply demonstrated by analysis of the long-term trends, but there have been some developments in the last six years that are providing additional food for thought.

Fibre consumption trend

World fibre consumption rose from about 44 million tonnes in 1990 to 101 million tonnes in



from 18.6 million to 24.22 million tonnes, representing an average annual growth rate of about 1.1 percent, while that of man-made fibres rose from 18.55 to about 71 million tonnes, or about 5.5 percent per year. Polyester alone grew from 6.9 to 53 million tonnes, or about 8.5 percent per year. In 1990, polyester constituted 16 percent of total fibre consumption and 37 percent of all man-made fibres; by 2016, the proportions were 53 percent and 75 percent respectively. In summary, in the period between 1990 and 2016 the market share of cotton came down from 42 to 24 percent, while that of man-made fibres increased from 42 to 70 (polyester rising from 16 to 53).

World area and yield

Over the past 60 years, the global area under cotton has remained in the range of 29 to 36 million hectares; however, in the past five years the figure sank from the top of this range to just 29.6 million hectares (owing principally to reductions in China). 2016/17 saw a bounce back to about 31.5 million hectares. The rise in global output over the longer term is attributable principally to improvement in yields, which coincided with the introduction of BT technology in the

late 90s. In 2013/14, the world achieved the highest-ever average yield of 800 kg/ha. Adverse growing conditions brought a dip in 2015/16, but last season witnessed a recovery, and the prospects are for a sustained or higher level to be attained in 2017/18.

World production

World cotton production ran in a range from 14 to 20 million tonnes in the 1980s, but then remained fairly flat in the following decade. It was boosted to a record level (approaching 28 million tonnes) in

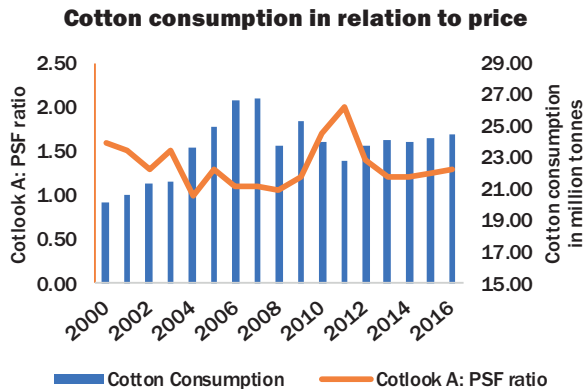
2016, representing a growth rate of about 3.36 percent per annum. On a per capita basis, textile fibre consumption increased over the same period from 8.5 kg to 13.8 kg per person per annum. The absolute volume was of course also boosted by increases in global population and prosperity.

For individual fibres, consumption of cotton increased



2011/12, on the back of expanded area, the increase having been prompted by the preceding season's record price levels.

Polyester/cotton price relationship and its impact on cotton consumption



A study conducted by the International Cotton Advisory Committee analysed the relationship between international prices for polyester and cotton and consumption of cotton. No firm conclusions were drawn, but some trends were noted.

For instance, the report commented that when the price of cotton remains under 30 percent higher than polyester fibre, then consumption levels of cotton are maintained or increased. When the price

differential increases beyond that point, though, polyester moves into favour.

However, more recent observations have indicated that falling polyester prices might be less influential on cotton consumption than previously thought. Cotton fibre currently has a price premium of about 80 percent over polyester, and yet cotton consumption is still on the rise.

Consumer preference for cotton or cotton-rich garments appears to be one of the most significant factors driving demand, as clothing accounts for between 52 and 55 percent of cotton consumption. A global lifestyle survey conducted by Cotton Incorporated demonstrated the importance of fabric type when it comes to consumers making a decision to purchase.

According to the survey, 95 percent of consumers in Italy, as well as 86 percent in India, 85 percent in Brazil and 83 percent in China said that fibre content is one of the most important factors influencing their choice. And, there is a marked preference for natural fibres: 93 percent of consumers in India, 92 percent in Italy and 88 percent in the UK stated that they prefer cotton clothing, many citing reasons such as comfort, softness, breathability and environmental impact. Moreover, 81 percent of global respondents perceived that cotton and cotton blends are best suited to current fashions, and said that it is the material they are least likely to avoid.



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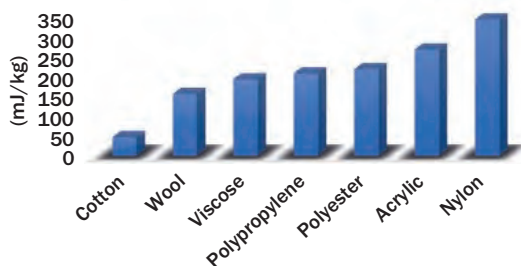


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Cotton's diminishing impact on the environment is another favourable factor. Innovations in farming have combined to reduce cotton's environmental footprint over the last 35 years. A study conducted by the University of Queensland found that cotton production now results in far less CO₂ per kilogram of fibre – less than half that produced by polyester (4kg vs 8.9kg). In terms of energy consumption, too, cotton is by far the cleanest and most economical of the common fibres: the energy used to produce a kilo of cotton is 46.4 megajoules, compared with 192 for viscose, 217 for polyester and 342 for nylon.

Comparison of energy consumption of cotton and other products from field to fabric



In consequence, many major brands, including Nike, Levi's and Puma, have re-aligned their strategies and have adopted commitments to shift a percentage of their manufacturing (and in some cases their entire product range) to sustainable cotton.

The best-known and most successful sustainability programme is that of the Better Cotton Initiative (BCI). Today, BCI cotton accounts for 12 percent of global production

and the organisation has a target of reaching 30 percent by 2020. Other brands, such as Gildan, Macy's and Carter's, have formed partnerships with BCI and are committed to reducing the carbon footprint, energy consumption and fresh water consumption involved in the production of their goods.

Challenges for cotton

Cotton still faces challenges, not only from increased synthetic fibre consumption, but from competing crops and requirements for long-term production sustainability and improved quality specifications.

Rising costs of production pose a serious threat to farmers' incomes as well as to long-term sustainability. Farming practices need constantly to be reviewed and updated, and breeders, researchers and farmers must work together to give fresh momentum to gains in yields. Rapidly-evolving technologies need to be supported, and innovations, such as the use of Gossypol-free seeds, and cotton stalks for bio fuels, bio-chemicals and food products, which will in future create more value for the cotton economy, must be pursued.

Of course, the weather remains a significant risk factor in cotton production, and one that is much more difficult to mitigate. In the Subcontinent, erratic Monsoon patterns and rainfall levels have always worried producers. In a broader context, much attention is focused on the impact on cotton production of climate change.

A further challenge is that today's consumers are increasingly open to trying out new materials that may have appeal in terms of either economic benefits or attributes.

In conclusion, overall cotton consumption has recovered some ground over the past six years but a number of significant challenges have still to be tackled.



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