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Brazil

Cotton and Products

Cotton Update

2005

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Report Highlights:

Post estimates 2004/05 production at 1.29 million tons, which is nearly identical to last year's crop. Production for 2005/06 is forecast down 110,000 tons from the previous Post forecast to 1.15 million tons due primarily to poor prices and tight credit. As a result of the lower production forecast, Post lowered 2005/06 exports to 400,000 tons. Discussion with industry and government contacts reveals that biotech cotton seed should be ready for commercialization in 2006/07 while the use of illegal biotech seed should increase substantially this upcoming crop year.

Includes PSD Changes: No
Includes Trade Matrix: No
Unscheduled Report
Brasilia [BR1]
[BR]

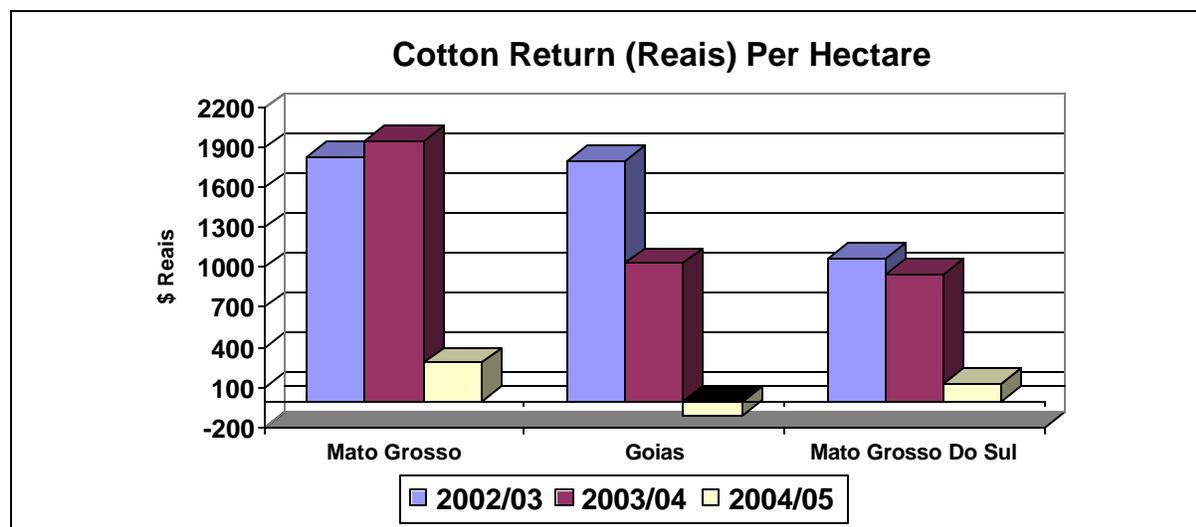
PS&D

Brazil							
Cotton							
	2003	Revised	2004	Estimate	2005	Forecast	UOM
	USDA Official [Old]	Post Estimate [New]	USDA Official [Old]	Post Estimate [New]	USDA Official [Old]	Post Estimate [New]	
Market Year Begin		08/2003		08/2004		08/2005	MM/ YYYY
Area Planted	0	1100000	0	1172000	0	1000000	(HA)
Area Harvested	1100000	1100000	1172000	1172000	1030000	1000000	(HA)
Beginning Stocks	627052	200000	1007203	532148	1106269	629306	(MT)
Production	1309625	1309400	1284587	1290000	1219269	1150000	(MT)
Imports	118661	112648	46158	46158	43545	60000	(MT)
MY Imp. from U.S.	0	64000	0	19	0	15	(MT)
TOTAL SUPPLY	2055338	1622048	2337948	1868306	2369083	1839306	(MT)
Exports	209888	209900	339000	339000	381021	400000	(MT)
USE Dom. Consumption	860020	880000	914452	900000	892679	920000	(MT)
Loss Dom. Consumption	-21773	0	-21773	0	-21773	0	(MT)
TOTAL Dom. Consumption	838247	880000	892679	900000	870906	920000	(MT)
Ending Stocks	1007203	532148	1106269	629306	1117155	519306	(MT)
TOTAL DISTRIBUTION	2055338	1622048	2337948	1868306	2369082	1839306	(MT)

Production

Post estimates 2004/05 production at 1.29 million tons, down 110,000 tons from the previous Post forecast. The reduction is primarily due to lower than expected yields in Mato Grosso due to dry conditions late in the growing cycle. Post's estimate matches that of Conab. As has been stated in past reports, Conab has a very good reputation among cotton producers and organizations for its accuracy in cotton production forecasting. Though Post occasionally differs on out-year forecasts, forecasts are generally closer than those for rice, wheat, and corn.

Yields for the recently harvested crop were down from last year in the states of Bahia, Mato Grosso, Mato Grosso do Sul, Goias, Sao Paulo, and Parana. Drought in Mato Grosso and Mato Grosso do Sul resulted in decreased yields while heavy rains resulted in fungus development and rotting in other regions.



Source: FNP & Post. Post adjusted FNP 2005 figures to reflect current yield estimates, current exchange rate, and updated June prices received by producers.

The Post forecast for 2005/06 area is lowered to 1.0 million hectares and production to 1.15 million tons. Forecast area is nearly 15 percent lower than last year. One of the principal challenges facing cotton producers is their heavy debt burden. Very healthy profits for cotton production from 2002 to 2004 encouraged producers to purchase additional land. According to Agrosecurity Consultoria, typical soybean/cotton land in Mato Grosso was purchased for about R\$2,000 (U.S. \$870) per hectare with a down payment of 25 percent and payments spread over seven years. Center-West producers also invested heavily in tractors and harvesters under the Moderfrota program with payments spread over several years. Excellent profits in 2002/03 (see chart above) further encouraged growers to take advantage of the Moderagro government program whereby loans are taken to correct the soil and recoup degraded pasture. With all this indebtedness incurred during the boom years and producers faced with large payments and the prospect of a second year of very low prices, Agrosecurity forecasts a negative return of 4.4 Percent for cotton in 2005/06. As the chart above demonstrates, profits were minimal to negative last year and the situation has not improved as producers prepare to plant the 2005/06 crop.

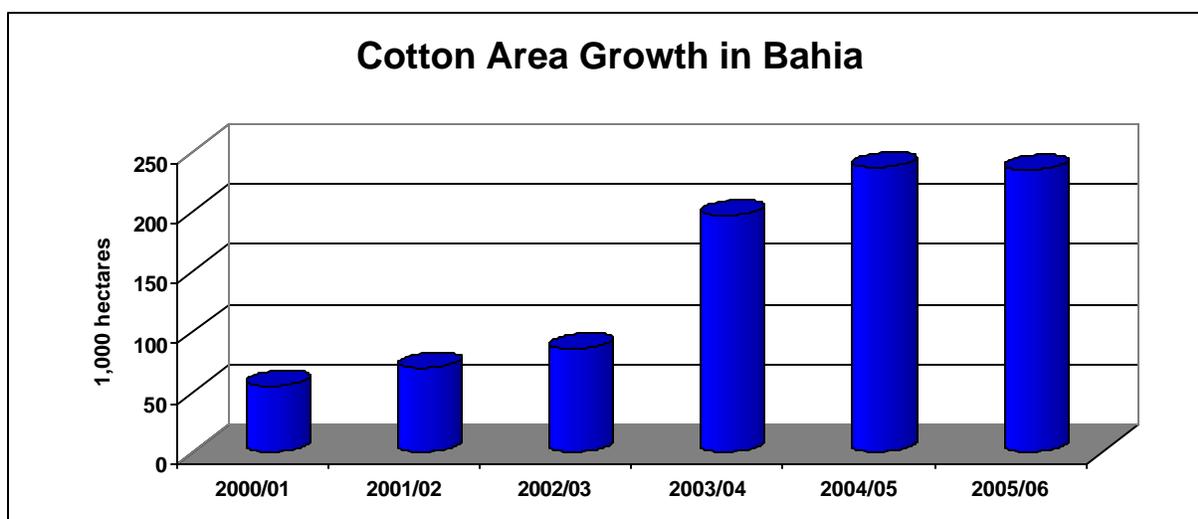
The forecast reduction in area is also due to an unfavorable exchange rate. Growers planted cotton when the exchange rate was R\$3.30 to the dollar and at harvest the rate was just R\$2.40. Since much of the inputs for cotton are imported and more than one-third the crop is exported, the valuation of the Brazilian currency has hit the cotton industry even harder than other summer crops such as corn and rice. Other factors that point to a reduction in area include high interest rates and tight available credit. Additionally, some producers were hopeful that they would be able to plant biotech seed this year (see biotechnology section) thereby reducing production costs by an estimated 15 percent. However, these hopes have been dashed and it now appears that it will only be in 2006/07 that biotech cotton seed will be approved for use.

Producer Seed Cotton Prices in Mato Grosso													
R\$/15 kg													
	Jan	Feb	March	April	May	June	July	Aug	Sept	Oct	Nov	Dec	Avg.
2003	17.4	18.1	18.5	18.5	18.2	17.7	17.5	17.7	17.5	18.2	20.0	20.0	18.27
2004	20.7	21.0	21.2	20.7	20.5	18.8	17.6	17.6	17.1	16.8	16.6	16.3	18.66
2005	16.7	16.1	15.6	14.1	12.0	12.7	12.4	12.2	12.5				13.81

Source: CONAB

Post believes that much of the reduction in area will be seen in Parana and Sao Paulo. In these states cotton farms are much smaller and less capital intensive than in Mato Grosso and Western Bahia. As a result, they are able to move more easily to alternative crops. For this reason, some planted area in northwestern Parana should move from cotton to sugarcane as new ethanol plants in the region are constructed. Meanwhile, massive investments in on-farm cotton gins and harvesters means that production in Mato Grosso and western Bahia is less prone to a significant year-to-year area reduction. However, conditions in Bahia are more favorable to cotton than other states in the Center-West region.

Post forecasts that planted area in Bahia will be even with last year and thus Bahia should be the only state not to experience a reduction in area. Weather and topography in western Bahia are ideal for cotton production and, unlike in Mato Grosso, commercialization is very attractive. Nearly half of Brazil's cotton is consumed in the Northeast and western Bahia is just 550 miles from the Northeastern port of Salvador. Therefore, cotton is relatively easily shipped to nearby Northeastern ports or exported outside Brazil. Approximately 25 percent of all Bahian cotton should be exported this year while the figure next year should climb to 35 percent. Advance contracts (both domestic and export) already account for 40 percent of production for the crop to be planted later this year. With this relative ease of commercialization, average prices in Bahia are better than in other production regions of the Center-West and are expected to offset the disincentives to production in Brazil discussed early in this section.



Trade

Exports for the 2004/05 marketing year (August/July) totaled 339,000 tons, which is 129,000 tons greater than the previous year. The top market for Brazilian cotton was Indonesia with 59,000 tons sold, more than double that of the previous year. Meanwhile greater exports to Japan, Pakistan, and Thailand compensated for a dramatic drop in shipments to Argentina. Post forecasts exports for the 2005/06 year at 400,000 tons, which is down 50,000 tons from the previous forecast due to a smaller than expected crop. However, the forecast of 400,000 tons is 60,000 tons greater than last year. Shipments have been very strong the past two months with exports for August and September at over 110,000 tons despite a very unfavorable exchange rate. China and Pakistan have picked up the pace of Brazilian purchases and imports by these two textile suppliers should continue

strong through the rest of the year due to increasing textile production combined with concern over the size of the Chinese crop this year.

Brazilian Cotton Exports by Destination		
1000 tons		
	Aug 2003 to July 2004 12 months	Aug 2004 to July 2005 12 months
Indonesia	21	57
Japan	27	33
Pakistan	12	30
Thailand	10	29
Argentina	42	22
China	18	17
S. Korea	12	14
Germany	6	11
Taiwan	4	11
Peru	2	11
Portugal	5	10
Others	54	94
Total	210	339

For the third straight year imports fell in Brazil with imports for 2004/05 totaling just 46,000 tons as purchases fell dramatically in the second half of the year. Paraguay was the top exporter supplying over half of Brazil imports while imports from the United States fell to just 19,000 tons, compared to 68,000 tons in each of the two preceding years.

Brazilian cotton industry contacts believe that the WTO decision on U.S. cotton support programs will lead to a reduction of U.S. exports by 40 percent and a increase in Brazilian exports by as much as 16 percent. Though Post feels the increase in Brazilian exports will be due to greater demand rather than less competition from the United States, exports are expected to be strong over the next several months. Producers, including the President of the Cotton Producers Association (ABRAPA), see Brazil as the only country that can fill the gap in exports left by an expected U.S. export reduction. Industry leaders believe that Brazil will be the top cotton producer in a matter of a few years and the leading cotton exporter. However, for Brazilian exports to increase improvements will be necessary in logistics and the quality of cotton. Though the quality of cotton in the field is reported to be quite good, industry leaders report that quality deteriorates during harvesting and ginning due in part to the equipment used.

Principal Long-Term Challenges to Brazilian Cotton Exports
• Excess of leaves and stems in the cotton
• Non uniform lots
• Poor quality bale coverings which don't provide full coverage
• Low quality bale wire
• Long delays in ship loading
• Shipping instructions that are not strictly executed
• Loss of quality and cleanliness of bales during transport and loading
• Loading of the wrong lots

*Source: Anea and Panorama Rural

Consumption

Internal demand for cotton should get a boost over the next several months as the Brazilian government imposes safeguards on the import of Chinese textiles. Domestic textile companies have pressured the government to allow higher tariffs as imports from China have soared. Reports suggest that the textile sector has already filed 70 requests for protection with the argument that 75 products are facing unfair Chinese competition. However, at least part of the surge in textile imports can be attributed to the very strong currency with the exchange rate at just R\$2.20 to the U.S. dollar. For the first 8 months of the calendar year, imports of textiles from all destinations were up six percent over last year.

While there has been a surge in textile imports, domestic use is supported by very strong exports of textiles. Despite the unfavorable exchange rate, exports to the United States and Argentina have been strong. Additionally, the industry has dedicated R\$600 million to a marketing campaign to increase consumption of cloths made with 100 percent cotton.

Post forecasts consumption in 2005/06 at 920,000 tons, which is 20,000 tons above the previous year's estimate. The Post forecast is in the mid-range of industry forecasts by ANEA, Safras, and CONAB, which are all around 900,000 tons.

Biotechnology

On March 17th, the National Technical Commission on Biosafety (CTNBio) approved the commercialization of Bollgard cotton seed and in late June the first shipment (2,200 tons) was imported into Brazil by DelataPine and Grupo Maeda (MDM). However, the seed must undergo field tests by the Ministry of Agriculture before commercialization. Normally this process would take two years, meaning commercialization could only begin in 2007/08. However, the Ministry found a loophole in the law allowing for only one year of testing if the biotech trait is placed in an already approved conventional variety. Therefore, the joint venture group MDM should have Ministry approval for commercialization in 2006/07 and thus in early October was given permission to begin multiplying seed. MDM reports that Bollgard seed will be available for commercialization and the company expects that 50 percent of the 2006/07 crop will be planted with transgenic seed.

Producers are somewhat disappointed as they were very anxious to use the seed this year and claim that the lengthy bureaucratic process will hurt producer profits and the competitiveness of Brazilian cotton compared to biotech cotton from Australia and the United States. Sources also suggest that as much as 30 percent of the upcoming crop could be illegally planted with biotech seed. As a result, the Ministry of Agriculture has promised that growers that use illegal seed will lose the right to government support mechanisms and has taken steps to increase inspection of seed.

Currently in Brazil the two events planted illegally are BT and Roundup Ready cotton, Post is not aware of any illegal planting of stacked BT & RR seeds. As mentioned above, it is estimated that once the economic and agronomic studies are completed for BT cotton it will be registered in the SNPC seed registry and released for the 2006/07 crop year. However, it could be several years before RR seed is commercialized, as economic studies have not even begun. Sources suggest illegal planting of BT cotton this year could reach 25,000 to 30,000 hectares.