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Brazil

Cotton and Products

Annual Report

2006

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Report Highlights:
Post forecasts production for the current crop at 1.0 million tons on 825,000 hectares. Exports are forecast at a record 450,000 tons and imports at 50,000 tons. Exports for 2006/07 (beginning in August 2006) are forecast at 380,000 tons with imports at 150,000 tons. Post forecasts production for next year at 1.2 million tons on 1.0 million hectares.

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

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Economic Overview

Brazil's economy, aided by favorable international economic circumstances, has dramatically improved its external accounts. Although GDP growth dropped to 2.3% in 2005, down from a strong performance (4.9%) in 2004, Brazil has experienced booming exports, healthy external accounts, low inflation, decreasing unemployment and reductions in the debt-to-GDP ratio. Economic activity should pick up in 2006; the markets expect GDP growth of about 3.5%. Buoyed by exports and investment inflows, the Real has remained at strong levels, allowing the government and businesses to pay down external debt. The government pre-paid its IMF obligations, its last remaining rescheduled Paris Club obligations, and in April 2006, it announced it had retired the last of its Brady bonds. This removes from the books all restructured debt associated with Brazil's late-1980's default. Based upon the improving external debt dynamics, Fitch IBCA upgraded its credit rating on Brazil's sovereign debt in February 2006, to BB (two notches below investment grade). The economy also has shown resilience, remaining for the most part unaffected by a major political scandal and the replacement of the finance minister. However, the strong domestic currency is beginning to have adverse effects on Brazilian exports of key products.

Despite this considerable progress, key challenges remain. The public sector-debt-to-GDP ratio is on a downward trend but remains high, at about 52%. Real interest rates are among the highest in the world; reducing them will require both reductions in the government's borrowing requirement and reform of the financial sector and the judiciary. Income and land distribution remain skewed. Investment and domestic savings are low, although growing. The informal sector constitutes between 35 to 40 percent of the economy, in part because the tax burden (nearly 38 percent of GDP) is high. Achieving and sustaining high growth rates requires the implementation of more of the government's structural reform agenda and increased efforts to build a more welcoming climate for investment, both domestic and foreign. There has been only marginal progress on the reform agenda after passage of multiple measures in 2003 and 2004.

	1999	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006***
GDP Growth	0.9	4.0	1.5	1.9	0.5	4.9	2.3	3.5
Inflation	8.9	6.0	7.7	12.5	9.3	7.6	5.7	4.2
Average Exchange Rate (R$/US$)	1.81	1.83	2.35	2.93	3.07	2.93	2.44	2.32
Total Exports (US$ billion)	48.1	55.0	58.2	60.4	73.1	96.5	118.3	124
Total Imports (US$ billion)	49.2	55.7	55.5	47.2	48.3	62.8	73.5	85

Source: Central Bank and Ministry of Planning
Inflation Source: IPCA/IBGE
* Forecast

PS&D

Brazil							
Cotton							
	2004	Revised	2005	Estimate	2006	Forecast	UOM
	USDA Official [Old]	Post Estimate [New]	USDA Official [Old]	Post Estimate [New]	USDA Official [Old]	Post Estimate [New]	
Market Year Begin		08/2004		08/2005		08/2006	MM/YYYY
Area Planted	0	1151800	0	825000	0	1000000	(HA)
Area Harvested	1172000	1172000	850000	825000	0	1000000	(HA)
Beginning Stocks	1007203	920155	1106269	1001786	888542	689786	(MT)
Production	1284587	1284587	1023315	1000000	0	1200000	(MT)
Imports	46158	46135	43545	50000	0	150000	(MT)
MY Imp. from U.S.	0	0	0	0	0	0	(MT)
TOTAL SUPPLY	2337948	2250877	2173129	2051786	888542	2039786	(MT)
Exports	339000	339091	435453	450000	0	380000	(MT)
USE Dom. Consumption	914452	910000	870906	912000	0	930000	(MT)
Loss Dom. Consumption	-21773	0	-21773	0	0	0	(MT)
TOTAL Dom. Consumption	892679	910000	849133	912000	0	930000	(MT)
Ending Stocks	1106269	1001786	888542	689786	0	729786	(MT)
TOTAL DISTRIBUTION	2337948	2250877	2173128	2051786	0	2039786	(MT)

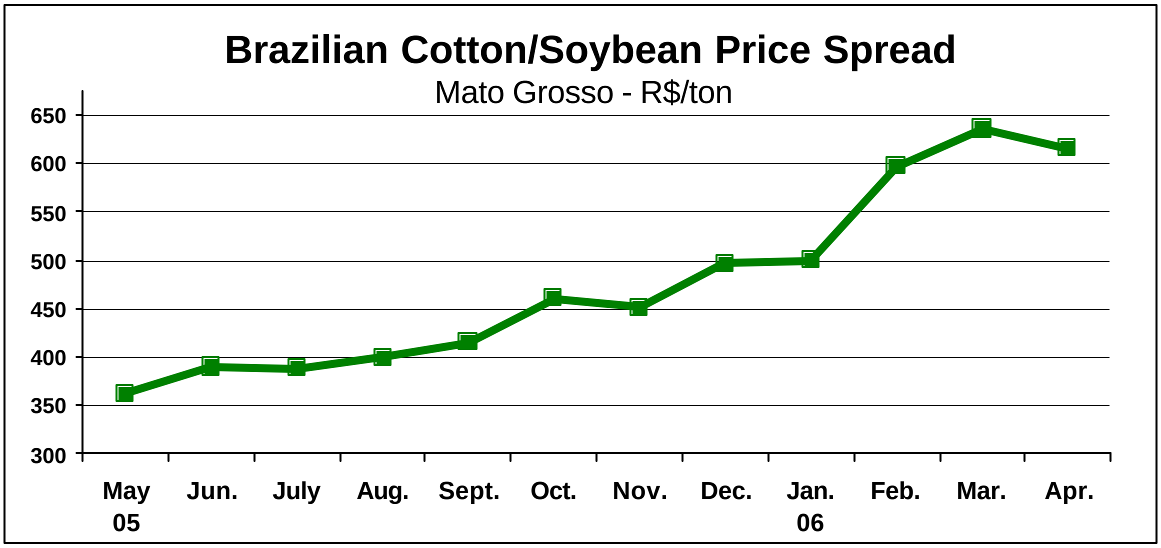
Production

Following several years of exceptional returns and increasing production, the 05/06 crop is forecast by Post to be down nearly 300,000 tons from the previous year to just 1.0 million tons. With the height of harvest beginning in just a few weeks, a fall in production is clear due to less planted area, which declined for the first time in three years. The fall in area is the largest decrease in 10 years and is due to a unique set of adverse circumstances, which Post does not expect to be as severe in 2006/07. Principal factors behind the drop in planted area include difficulty in obtaining credit, low cotton prices, and high input costs. Total area is estimated by Post at just 825,000 hectares, which is 30 percent less than last year. The greatest drop in percentage terms was in the South but the states of Mato Grosso and Goias were responsible for most of the overall drop in hectares. It should be noted that the current area forecast, though down dramatically from last year, is greater than early season estimates. This is due to a slight increase in cotton prices at planting in December and a fall in the price of soybeans, which is the primary competing crop for area. In addition, input costs fell in the months leading up to cotton planting thus encouraging some producers to opt for cotton.

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	12.7	12.6	12.6	13.1	12.9	14.0	**13.76**
2006	13.7	14.5	15.6	*15.3*									**14.77**

Source: CONAB

Despite the large fall in area, production is forecast down by a smaller percentage, 22 percent less than last year, as yields are expected to improve from 2004/05. The Center-West states of Mato Grosso, Goias, and Mato Grosso do Sul were impacted by drought last year but thus far in the growing season weather conditions have been near ideal. Post agrees with the CONAB forecast of a yield increase of 10 percent over last year for an average yield of 1.2 tons per hectare. While early-planted (December) cotton in Mato Grosso has been impacted by excessive rains near harvest, which may lower yields, these same rains have benefited the majority of the crop, which was planted later. In Bahia and Goias, producers are concerned about the excessive rain but report that there is still time for drying before harvest in late May and June.



Data Source: CONAB & Safras

Post forecasts that both area and production next year will recover with both increasing by 20 percent. Area is forecast at 1.0 million hectares and production at 1.2 million tons. Below are several factors that support this forecast for a recovery in production:

1) Historically, interest rates in Brazil fall in an election year and rates have already started to decline six months before the election. High interest rates along with tight credit for the planting of the 2005/06 crop were influential on producers' decisions to reduce area but this situation should improve slightly before planting this coming November.

2) Even though the currency is currently very strong, expectations are that with the upcoming election, there will be a slightly more favorable exchange rate in late 2006. Since about one third of the crop is exported, the strong and unfavorable exchange rate reduced producer prices greatly this past year.

3) The smaller crop and continued strong exports should lead to improved prices, which have already strengthened since January. Domestic cotton consumption is strong and most industry contacts believe that, though prices should remain fairly low this year, producers will obtain better prices for the current crop than for the 2004/05 crop and thus be more optimistic for planting this fall.

4) Though it is difficult to forecast petroleum prices for the coming year, prices in Brazil have eased over the past few months and subsequently so has the price of petroleum based fertilizers. Along with fertilizers, data suggests that overall input costs are falling and should be more favorable for planting this coming fall.

5) Cotton producers are generally optimistic about the global supply and demand situation for cotton and many are encouraged by the results of the WTO cotton case and expect less competition from U.S. exports.

6) Competing crop prices are very unattractive as evidenced by the cotton/soybean price spread which has increased more than 70 percent over the past 11 months.

Cotton Area, Yield, and Production					
	2002/03	2003/04	2004/05	2005/06*	2006/07*
Area (million hectares)	0.74	1.10	1.17	0.83	1.00
Yield (tons/hectare)	1.15	1.19	1.09	1.20	1.20
Production (million tons)	0.85	1.31	1.28	1.00	1.20

* Post Forecasts

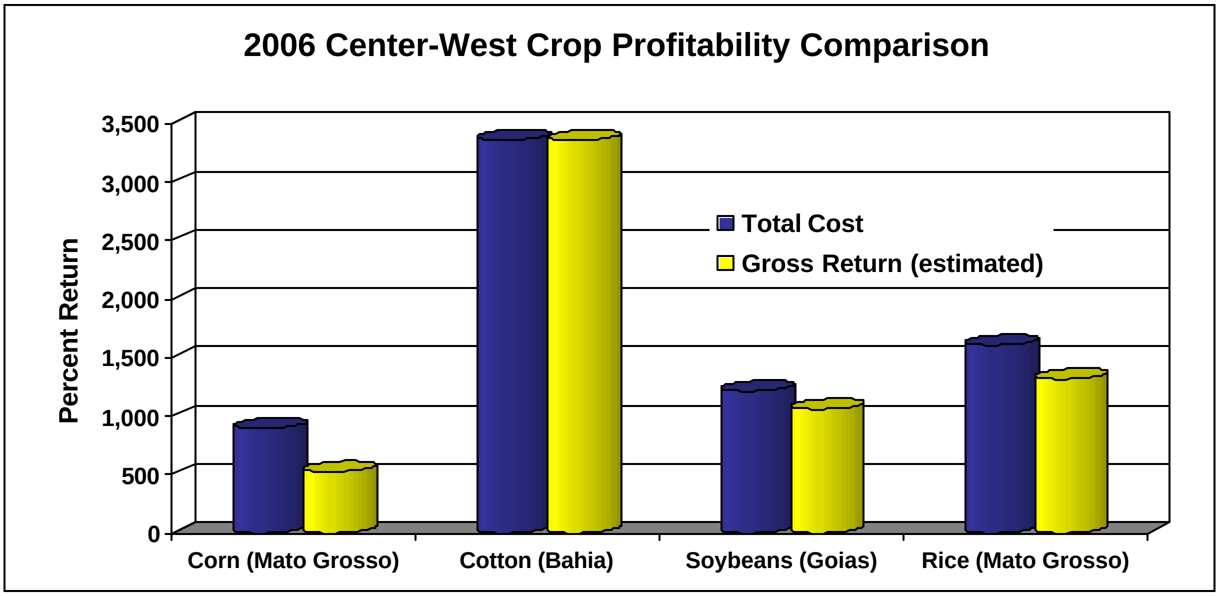
Though the factors listed above strongly suggest area and production will recover next year, there are also several competing market factors that restrain an even further increase in area to a potential planted area of 1.1 million hectares and production of 1.3 million tons. While expectations are that the currency will weaken, to this point it still remains very strong thus discouraging textile exports. The strong currency is also encouraging imports of competing fibers thus further dampening current domestic cotton use. This restrained domestic use combined with sufficient stocks is keeping domestic prices down. However, as stated above, several factors, including the much smaller crop, should lead to higher prices for the second half of the year thus encouraging producers to increase planted area.

Center-West

Western Bahia, Goias, and Mato Grosso are the top producing states in the Center-West or Cerrado region. These three states accounted for 75 percent of national planted area this year at 621,000 hectares. Improving prices for cotton combined with the poor profit performance of soybeans and corn should lead to increased cotton production in these states in 2006/07. In a recent trip to Mato Grosso, Post learned that many producers simply can't make a profit with soybeans due to increased costs related to soybean rust, high transportation costs, and low producer prices. As a result, many producers plan to increase cotton acreage in hopes of better returns. For example, the Maggi group plans to increase cotton area by 60 percent next year while reducing corn and soybean acreage. According to the company director, cotton is the only crop that can produce a profit given current commodity prices and costs of production.

Though the cost of production for cotton is triple that of soybeans, the spread in FOB and farm-gate prices for each crop is less dramatic for cotton due to its higher value. Therefore, cotton is less impacted by transportation costs. For instance, the farm gate price of soybeans in Sorriso, Mato Grosso is about U.S. $158 per ton while cotton is U.S. $476 per ton. Therefore, with that flat freight from Sorriso to the port of Santos at about $70 per ton, this equates to 44 percent of the price of soybeans but only 15 percent that of cotton. Thus the recent increases in transportation costs are impacting soybeans much more than cotton.

Furthermore, only 35 percent of the cotton crop is exported compared to over 80 percent of soybeans, and thus the high exchange rate, though significant, has less of an impact on cotton.



Source: FNP

South

Planted area is expected to be minimal in Sao Paulo and Parana for the 2006/07 crop as Post forecasts only 60,000 hectares combined (5 percent of total planted area in Brazil). Area and production have steadily fallen each year since 1985/86 when Sao Paulo and Parana were the top two producing states. In 2005/06, planted area in these states was less than 10 percent that of 25 years previous. Average farm size in Parana and Sao Paulo is much smaller than in the top producing states of Mato Grosso, Goias, and Bahia. Furthermore, the cost of production is higher in these states and as a result area is migrating from cotton to sugar cane for use in nearby ethanol plants. Recently, even the President of the Sao Paulo Cotton Producer's association decided to give up his position and cease all planting of cotton in favor of sugar cane and soybeans.

Trade

With nine months of data available, total imports are just 23,000 tons. However, the pace of imports is expected to increase over the next few months before harvest due to expectations of tight supplies. Post forecasts imports for August 2005 to July 2006 at 50,000 tons. Private market analysts forecast calendar year 2006 imports at 150,000 tons and post expects that about 25,000 to 30,000 tons of this total will be imported between May and July (the final three months of this marketing year). Some textile companies expect their share of sourced cotton from imports to increase from 10 percent to 30 percent. Sources expect that the majority of these imports will be low to medium quality supplies from the United States, with most imported into the Northeast of Brazil where the textile industry uses the "draw back" system for lower duties on imported cotton for production of textiles for export. Meanwhile, imports for the industries in Southern Brazil are likely to come from Paraguay.

Post forecasts 2006/07 imports at 150,000 tons, which is triple that of the past two years and is the most since 1999/2000. The increase in imports is due to the current smaller crop and continued strong exports, leaving the domestic market in need of cheap, lower-quality imports to fill demand. In the second largest production state of Bahia, already nearly the entire crop has been sold before harvest, with the majority, 175,000 tons, committed for export to Europe. As a result, the textile industry in Northeastern Brazil will continue to import from outside the country in addition to shipments from interior production areas of

Brazil that receive a transportation subsidy under the government PEP program. Reports suggest that R$253 million (U.S.$120 million) will be used to support the PEP program for the current cotton crop.

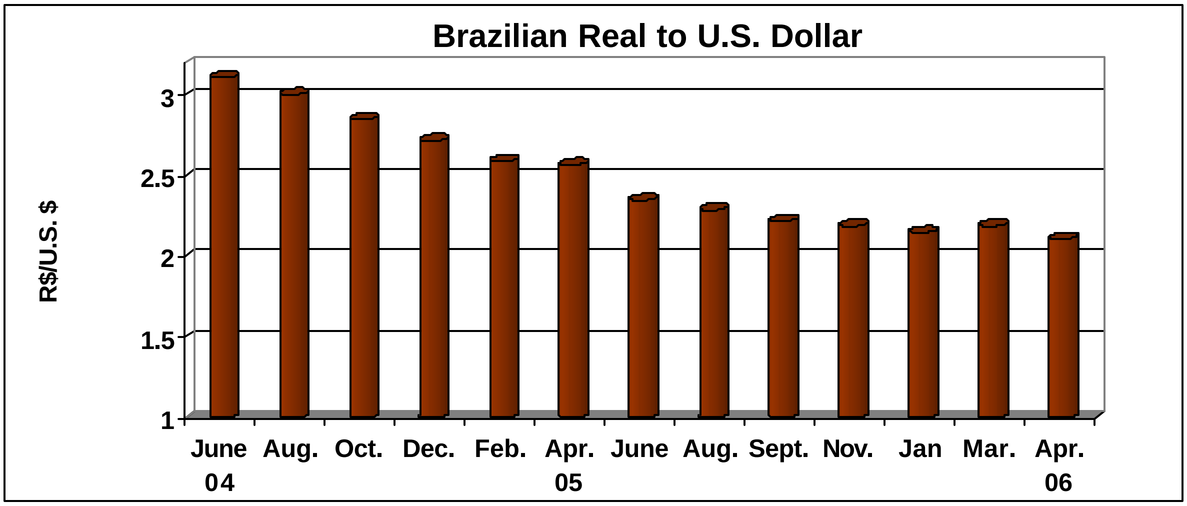
Exports for the period from August 2005 to July 2006 are forecast by Post at a record 450,000 tons. Though April, a total of 417,000 tons were exported with the primary destinations of China and Pakistan and to a lesser extent Indonesia and Japan. Exports are expected to slow over the next several months but finish the year at 450,000 tons or slightly higher.

Brazilian Cotton Exports by Month 1000 tons			
	2003/04	2004/05	2005/06
August	19.7	48.5	50.5
September	24.2	53.4	59.4
October	33.5	66.1	65.6
November	32.6	49.6	72.0
December	28.0	41.6	63.5
January	14.6	19.4	45.7
February	10.1	17.8	20.9
March	7.1	16.4	24.7
April	2.7	8.8	14.6
May	2.9	4.1	
June	8.2	1.8	
July	25.9	11.4	
Total	**210**	**339**	**417***

*Post forecasts total marketing year exports at 450,000 tons

August 2006 to July 2007 exports are forecast at 380,000 tons, down about 70,000 tons from the current year forecast. Most contracts for export were executed before planting and based on the expectation that the Brazilian currency would weaken to about $2.50/dollar. However, the currency has remained strong (see chart below) and thus there are rumors that some producers may not fulfill export contracts. This would do tremendous damage to the image of Brazilian cotton worldwide and sources expect that if this happens the government will step in to assist producers. Nevertheless, trade contacts believe that the cancellation of export contracts is not likely.

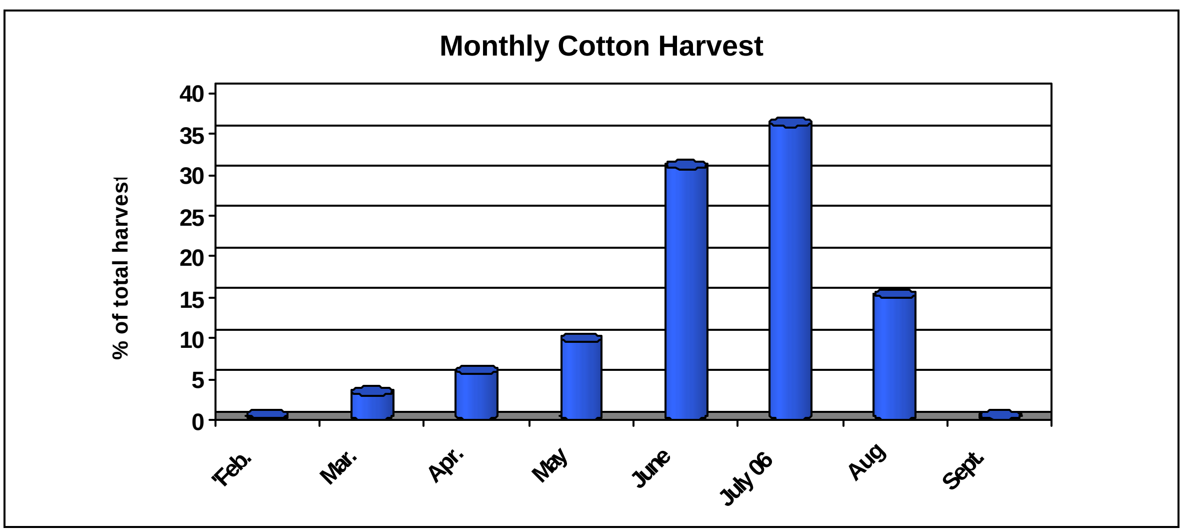
Information received from the state of Mato Grosso indicates that 200,000 tons of the crop to be harvested in the next few months has already been contracted for export with the other 200,000 tons destined for the internal market. Therefore, with exports from Bahia and Goias, the Post forecast of 380,000 tons of exports should easily be met.



Consumption and Stocks

High oil prices have raised the price of polyester and thus demand has slowed thereby benefiting cotton use in textiles. However, at the same time the strong currency is encouraging imports of man-made fibers. Generally in an election year, special measures are taken to create jobs and this should lead to increased demand for textiles throughout 2006.

Post has revised the stock series to better reflect actual market conditions. Post and Conab stock figures differ greatly as Post uses an August/July year while Conab figures are based on a calendar year. The tables below were used to estimate past stock levels as well to forecast stocks for the coming year. It is important to note that although the marketing year ends on July 31st, over 15 percent of the crop is unharvested at that point. Post forecasts beginning stocks as of August 1, 2006 at slightly less than 700,000 tons based on the expected import and export pace as well as crop supplies harvested to that point.



Source: CONAB

Post Monthly Production and Trade (1,000 tons)				
Month	**Production**	**Imports**	**Exports**	**Use**
08/04	**195**	**3.1**	**48.5**	**75.0**
09/04	2	2.5	53.4	75.0
10/04	0.0	2.5	66.1	75.0
11/04	0.0	3.1	49.6	75.0
12/04	0.0	3.5	41.6	75.0
01/05	0.0	3.0	19.4	75.0
02/05	2.6	2.4	17.8	75.0
03/05	38.6	3.8	16.4	75.0
04/05	71.9	7.0	8.8	75.0
05/05	122.0	7.8	4.1	75.0
06/05	394.4	5.1	1.8	75.0
07/05	461.2	2.1	11.4	75.0
08/05	**191.4**	**3.1**	**50.5**	**76.0**
09/05	1.3	0.7	59.4	76.0
10/05	0.0	0.7	65.6	76.0
11/05	0.0	1.3	72.0	76.0
12/05	0.0	0.5	63.5	76.0
01/06	0.0	0.7	45.7	76.0
02/06	2.0	2.0	20.9	76.0
03/06	30.0	3.8	24.7	76.0
04/06	56.0	10.5	14.6	76.0
05/06	95.0	9.0	4.0	76.0
06/06	307.0	9.0	4.0	76.0
07/06	359.0	9.0	25.0	76.0