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Brazil

Cotton and Products

Annual

2005

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Report Highlights:
Post raised 2004/05 lint cotton production to 1.40 million tons and area to 1.15 million hectares. Exports were lowered to 375,000 tons and imports to 60,000 tons. Production in 2005/06 is forecast at a record 1.50 million tons on 1.20 million hectares. Post forecasts exports at 450,000 tons and imports at 50,000 tons.

Includes PSD Changes: Yes
Includes Trade Matrix: Yes
Unscheduled Report
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Economic Overview

After weak economic growth in 2002 and 2003, 2004 proved to be a very good year. GDP expanded at a rate of 5 percent, the best result since 1994. Consumer price inflation dropped to 7.6 percent, down from 9.3 percent in 2003. Exports in 2004 reached an all-time record at US$ 96 billion. The agriculture sector accounted for 41 percent of all Brazilian exports and registered a positive balance of trade of 34 billion dollars. The agriculture sector also accounts for 30 percent of all GDP.

The Brazilian economic and political outlook is guardedly optimistic. Though Brazil's President, Luiz Ignacio Lula da Silva, known as Lula, hails from the Labor Party, he has continued the sound macroeconomic policies of his predecessor, Fernando Henrique Cardoso, since taking power in January 2003. In addition, Lula has shown an ability to press forward with reforms in the Brazilian Congress, which at least in the short run is more likely to ensure growth and expand tax revenues.

Economic Indicators

	1999	2000	2001	2002	2003	2004	2005
GDP Growth (%)	0.9	4.0	1.5	1.5	0.5	5.0	3.5
Inflation (%) (IPCA/IBGE))	8.9	6.0	7.7	12.5	9.6	7.6	5.0
Average Exchange Rate (R$/US$)	1.81	1.83	2.35	2.93	3.07	2.94	2.75
Total Exports (US$ billion)	48.1	55.0	58.2	60.4	73.1	96.0	101.0
Total Imports (US$ billion)	49.2	55.7	55.5	47.2	48.3	62.3	75.0

Source:
- Brazilian Ministry of Development, Industry and Commerce (MDIC)/Secretariat of Foreign Trade (SECEX) trade databases (1999-2004)
- Brazilian Institute of Geography and Statistics (IBGE) (1999-2004)
- Brazilian Central Bank trade data
- Current trend analysis

* GDP and Inflation Projections for 2005 are taken from the Central Bank of Brazil.

PS&D Table

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	1070000	0	1151800	0	1200000	(HECTARES)
Area Harvested	1100000	1100000	1150000	1151800	0	1200000	(HECTARES)
Beginning Stocks	627052	200000	1007203	532148	1110623	757148	(MT)
Production	1309625	1309400	1371677	1400000	0	1500000	(MT)
Imports	118661	112648	59875	100000	0	75000	(MT)
MY Imp. from U.S.	0	64000	0	60000	0	50000	(MT)
TOTAL SUPPLY	2055338	1622048	2438755	2032148	1110623	2332148	(MT)
Exports	209888	209900	435453	375000	0	450000	(MT)
USE Dom. Consumption	860020	880000	914452	900000	0	930000	(MT)
Loss Dom. Consumption	-21773	0	-21773	0	0	0	(MT)
TOTAL Dom. Consumption	838247	880000	892679	900000	0	930000	(MT)
Ending Stocks	1007203	532148	1110623	757148	0	952148	(MT)
TOTAL DISTRIBUTION	2055338	1622048	2438755	2032148	0	2332148	(MT)

Production

Post forecasts 2004/05 lint cotton production at 1.40 million tons on 1.15 million hectares, which is just 50,000 hectares and 90,000 tons more than last year. Post forecasts yields in Mato Grosso at 1.45 tons per hectare compared to 1.40 tons per hectare last year for total production of 617,000 tons. Growing conditions thus far in the year have been very good with sufficient rain and plentiful sunlight. Last year excessive rain and cloud cover impacted development; though yields were near record due to greater technology used and improved varieties. Some contacts in the state suggest yields could end up 15 percent greater than last year due to near-optimal growing conditions. However, overall production in Mato Grosso is expected to be about even with last year due to a 10,000-hectare fall in planted area. Excessive rains last year led to a late harvest for soybeans thereby preventing some farmers from planting a follow-up cotton crop.

Cotton Area, Yield, and Production					
	2001/02	2002/03	2003/04	2004/05*	2005/06*
Area (million hectares)	0.75	0.74	1.10	1.15	1.20
Yield (tons/hectare)	1.02	1.15	1.19	1.22	1.25
Production (million tons)	0.77	0.85	1.31	1.40	1.50

* Post Forecasts

Production in Sao Paulo is forecast at 75,000 tons, which is even with last year. However, the situation in Sao Paulo is the opposite of Mato Grosso as area in Sao Paulo is greater than last year but yields are down slightly due to a mid-season drought. Post believes that both IBGE and Conab area estimates for the state may be a bit low. Contacts estimate area is increasing faster than expected due to the profitability of cotton versus other crops over the past several years. Additionally, IBGE estimates for area in Bahia appear less accurate than Conab estimates. Based primarily on input form producer organizations and other contacts,

Post estimates area this year in Bahia is close to 240,000 hectares, which is 21 percent greater than last year. Meanwhile, yields in Parana and Mato Grosso do Sul are down from original expectations due to drought in January and February. Though cotton is more resistant to drought than other crops such as soybeans and corn, yields are expected down due to the prolonged nature of the drought in these states.

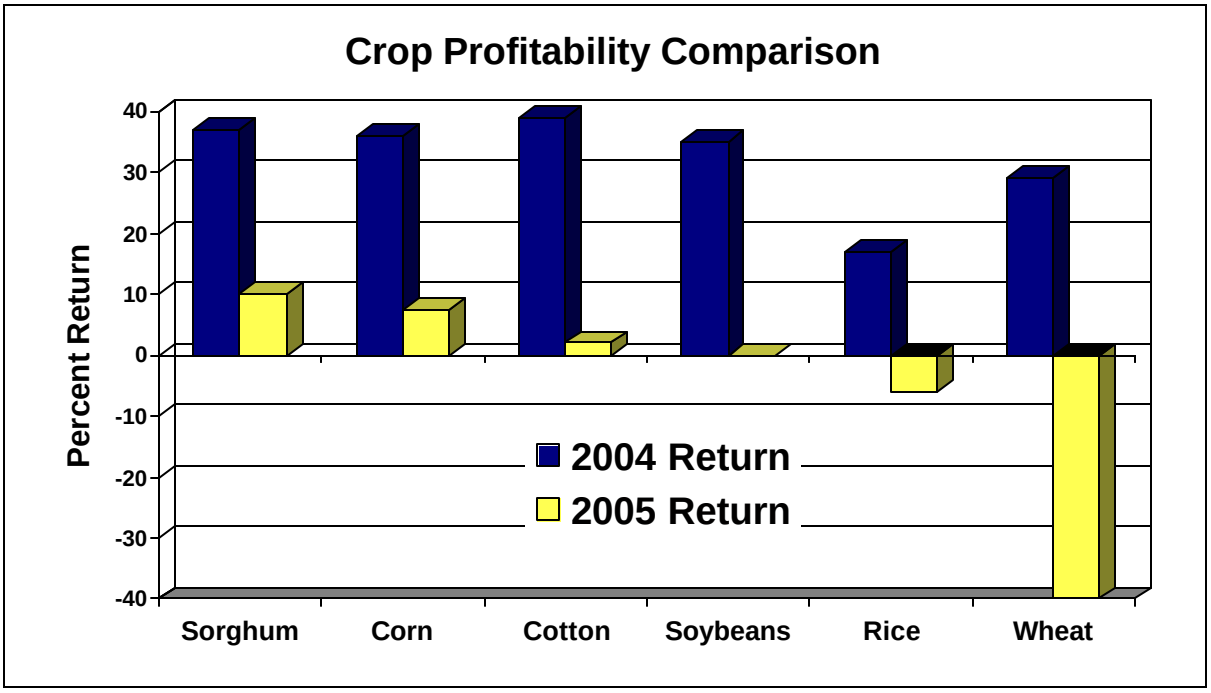
Post forecasts 2005/06 area at 1.2 million hectares and production at 1.5 million tons, which is just 100,000 tons more than the forecast for this year's crop and below the annual rate of expansion over the past decade. Assuming normal weather, yield is expected to increase to 1.25 tons per hectare due to new planting technology and improved cultivars. Meanwhile area will primarily expand in Western Bahia where new areas are brought into cotton production. Expansion in Bahia last year was about 20 percent due to proximity to the Northeastern textile industry resulting in better prices than in Mato Grosso. Nevertheless, the increase in production year-to-year will be limited by the high cost of inputs, low producer prices, and a strong currency, which limits exports.

Cotton Area, Yield, and Production
(1000ha; Tons/ha, 1000MT lint cotton)

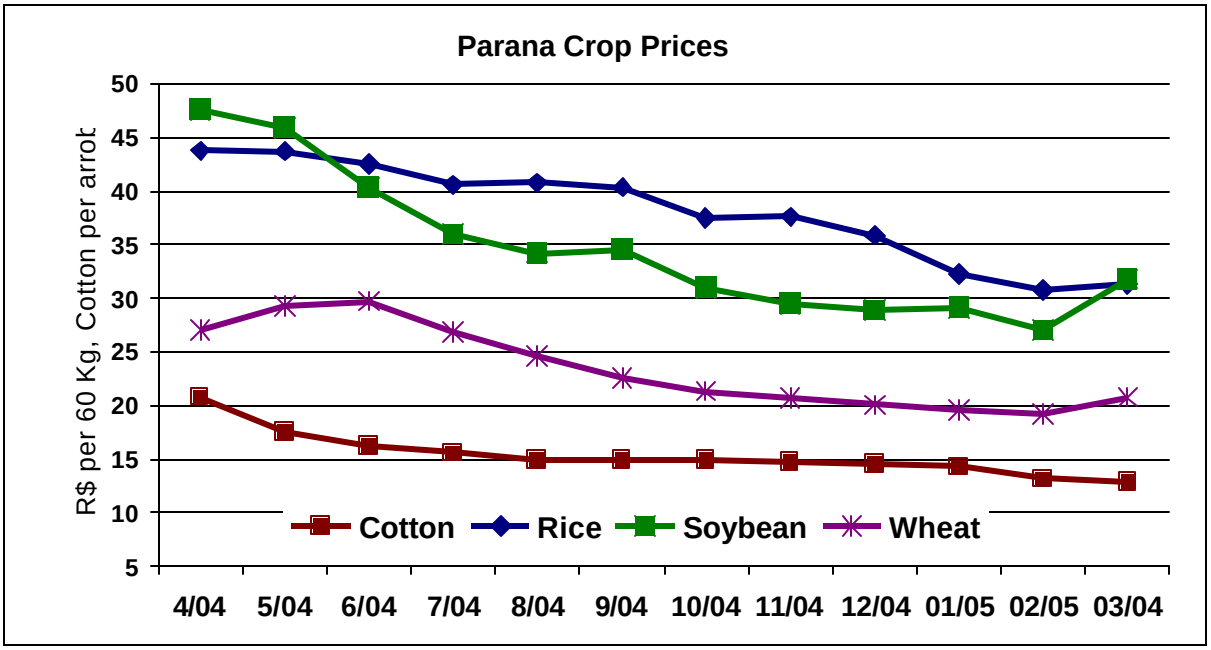
State	2004/05 (Estimate)			2005/06 (Forecast)		
	Area	**Yield**	**Production**	**Area**	**Yield**	**Production**
Mato Grosso	425.2	1.45	616.6	425.0	1.46	620
Bahia	240.0	1.36	326.4	265.0	1.40	371
Goias	143.7	1.27	181.8	150.0	1.30	195
Mato Grosso Sul	58.9	1.35	79.5	55.0	1.40	77
Sao Paulo	80.0	0.94	75.2	85.0	1.00	85
Minas Gerais	54.2	0.98	52.5	50.0	1.00	50
Parana	53.5	0.75	40.1	60.0	0.90	54
Others - N/NE	100.0	0.28	28.3	100	0.48	48
Total	1,155	1.22	1,400	1,200	1.25	1,500

Source: Post estimates and Post forecast

As the chart below demonstrates, cotton returns are expected to be down significantly this year compared to last year. This is primarily due to the very high cost of inputs at planting combined with low producer prices. Nevertheless, prices for all commodities are low in Brazil (see chart below on prices for all commodities over the past 12 months), and thus area shift to other commodities such as rice, soybeans, and corn, is not forecast. Furthermore due to the significant investment required for cotton production in the form of harvesters and gins, area reduction or a switch to other commodities is difficult.



Source: FNP and Post (2005 returns based on February producer prices)



Source: Deral

Global production should be impacted by low international prices for this year's harvests, which is expected to induce growers in the northern hemisphere to pull back on planted area. For the crop in Brazil to be planted in October through December of this year, it is expected that production costs will continue to be high but producers in Brazil expect international

prices to recover due to lower production in China and the United States. The Index A price forecast for 2005/06 is U.S. 57 cents/pound compared to 47 cents/pound in 2004/05. Furthermore, the approval in mid March of a Monsanto BT biotech cotton seed (see Biotechnology Section) is expected to lower production costs by 20 percent or more. Although it is unlikely that the biotech seed will be registered for use for this year, use of imported seed may be allowed for those producers that want to plant biotech seed in the coming year. Growers in the Center-West are also pleased by the level of advance selling for the crop to be planted in October. It is estimated that as of mid March, 15 percent of the crop to be harvested in 2006 had been forward contracted with over 100,000 tons contracted for export. Producers are also optimistic that the recent WTO decision on U.S. cotton support will lead to less export competition in the coming year. The Mato Grosso Cotton Producers Association has widely publicized its forecast that U.S. exports will fall by 40 percent in the coming year due the WTO decision and that Brazilian exports will increase by 20 percent.

Lint Cotton Production Costs
Mato Grosso (R$ per Hectare)

	2002/03	2003/04	2004/05
Mechanical Operations	641	923	1,332
Inputs	1,235	1,484	2,411
Administration	137	159	209
Post-Harvest Costs (includes Ginning)	415	311	317
Total Cost per Hectare	**2,428**	**2,877**	**4,259**

* R$2.55 = US$1.00

Cotton growers in Brazil generally make planting decisions between March and May, and with yields promising for this year crop and prices expected to recover, Post contacts in Mato Grosso believe area will be stable or expand slightly. Assuming a normal yield increase, this will likely translate into a slight expansion in production in the state. The situation is expected to be similar in Bahia except that area is expected to expand by about 10 percent. Producers in Bahia receive higher prices than producers in Mato Grosso due to the lower transport costs to the export port of Santos (near Sao Paulo). Furthermore, advance export sales (50 percent of the crop) for this year's harvest are greater than in other regions of the country and exports could begin to be shipped from the port of Salvador.

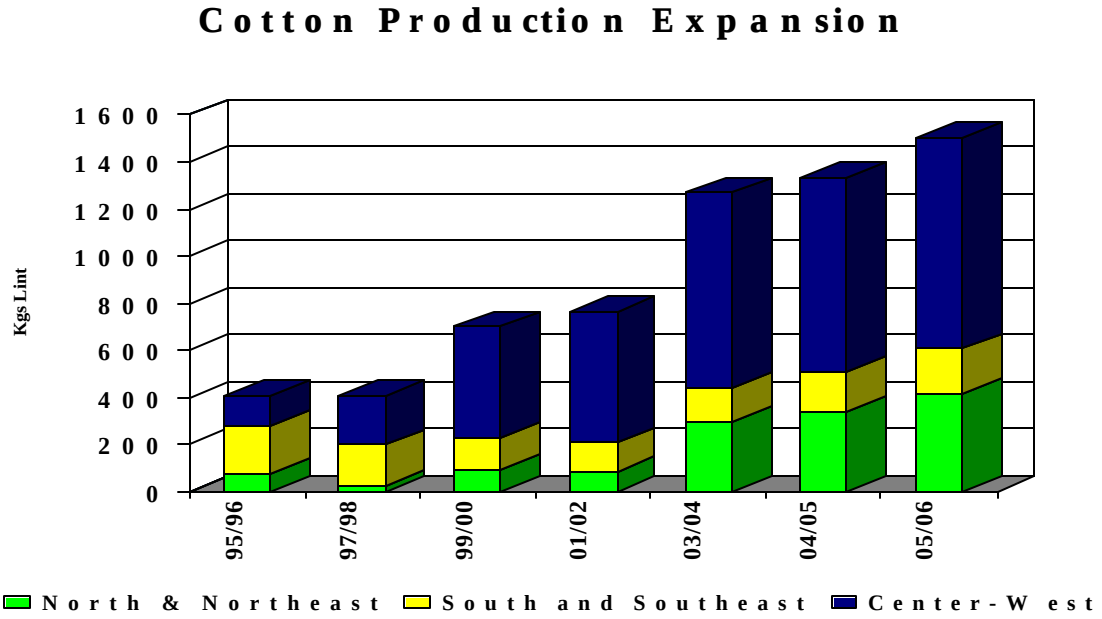
Producer Seed Cotton Prices in Mato Grosso
R$/15 kg

	Jan	Feb	March	April	May	June	July	Aug	Sept	Oct	Nov	Dec	Avg.
2001	9.6	9.6	9.5	9.4	9.3	9.3	9.3	9.3	9.3	9.3	9.3	9.3	**9.40**
2002	9.4	9.5	9.5	9.5	9.5	9.5	11.0	11.3	12.5	14.9	16.0	16.6	**11.58**
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	17.8	17.6	17.6	17.1	16.8	16.6	16.3	**18.66**
2005	16.7												

Source: CONAB

Along with expansion in Bahia, Post forecasts that both area and yields in Sao Paulo will expand, albeit from a very small base, due in part to state government tax incentives. In the early 1980s and before, Sao Paulo was one of the top production states in Brazil. However, since that time, production has fallen as cotton area has moved to the Center-West (see chart below). This is due to a combination of inexpensive land prices and new cropland opening in Mato Grosso and soaring land prices in Sao Paulo due to the profitability of orange and sugarcane production. However, cotton is gaining some ground in the state in a rotation following the winter crops of wheat and triticale and in summer rotation with soybeans and

corn. Cotton production is also spurred by demand from Sao Paulo city, which is estimated at 400,000 tons per year. With only 25 percent of that demand filled through production in the state, there is strong potential for continued expansion. Post forecasts 85,000 hectares planted in Sao Paulo in 2005/06.



Trade

Post forecasts 2004/05 exports at 375,000 tons. The strengthening of the Brazilian currency, slow expansion of the international economy, and low international prices, in part, due to the end of textile quotas has restrained shipments through most of the year. However, over the past few months a slight recovery in international prices has boosted export sales. Therefore, post forecasts around 60,000 tons of shipments over the remaining four months (April to July) in the year. Typically, April, May, and June are the lowest export months but July shipments should rebound as harvest pressure and subsequent low prices force out supplies. This July, Post expects very large exports due to the recent factors discussed above.

Exports in marketing year 2005/06 are forecast at 450,000 tons, which is 75,000 tons greater than in 2004/05. Early export sales of the 2004/05 crop are trailing the pace of the previous year. However a record level of exports is expected due to strong demand from China, which is expected to reduce acreage for the next crop and increase import demand as textile production raises due to the end of textile quotas. Therefore, China is expected to import more cotton and export more textiles. Indications of strong Brazilian exports can also be seen in advance selling of this year's crop. As of late March, producers were setting contracts for the 2004/05 crop at U.S.$0.60 per pound compared to the market price at the time of only U.S. $0.52 per pound.

Brazilian Cotton Exports by Destination 1000 tons		
	Aug 2003 to July 2004 12 months	Aug 2004 to March 2005 8 months
Indonesia	21	54
Japan	28	31
Pakistan	12	28
Thailand	10	27
Argentina	42	19
Italy	7	18
China	19	15
Korea	12	13
Germany	6	8
Others	47	99
Total	**210**	**312**

*Post forecasts total marketing year exports at 375,000 tons

Post forecasts imports in 2004/05 at 60,000 tons. Imports in 2005/06 are forecast down to just 50,000 tons due to more abundant and low-priced domestic supplies. Additionally, imports are now subject to the 9.25 percent PIS/COFINS tax for which they were previously exempt. The primary supplier to Brazil is expected to be the United States. In calendar year 2004, cotton was the top U.S. agricultural export commodity to Brazil valued at U.S. $85 million.

Brazilian Cotton Imports by Destination (1000 tons)		
Exporter	Aug 2003/July 2004	Aug 2004/March 2005 (8 months)
United States	64	8
Paraguay	34	12
Greece	3	0
Argentina	1	1
Togo	1	0
Israel	1	1
Egypt	1	1
Others	3	1
Total	**108**	**24***

* Post Forecasts 60,000 tons for Aug/July year

Consumption

Demand for cotton from the domestic textile industry is very healthy as high quality cotton is replacing other fibers in textile production. High prices for polyester, which is derived from petroleum, is a major factor leading to greater cotton demand. The Brazilian Association of Cotton Producers forecasts a 12.5 percent increase in consumption in 2005 to 900,000 tons.

Estimates of cotton use in Brazil vary widely among sources with the government, trade, and cooperatives all providing different projections, which range from 700,000 tons per year to 1.2 million tons per year. Some industry contacts report that no organization is performing an accurate survey to determine consumption and many textile companies underestimate use in an attempt to suppress cotton prices. Nevertheless, most Post contacts believe

consumption is around 900,000 tons a year and increasing. Post forecasts 2004/05 consumption at 900,000 tons and 2005/06 consumption at 930,000 tons.

Stocks

Government stocks of cotton vary significantly during the year but represent only a small portion of overall stocks. Meanwhile private stocks vary little with most textile companies holding about 2 months of consumption in stocks while cotton cooperatives and producers hold little in storage. However, CONAB estimates 2003/04 ending stocks at 185,000 tons, which is 60 percent greater than the previous year.

Post forecasts 2003/04 ending stocks at 532,148 tons and 2004/05 ending stocks at 757,148 tons. Post forecasts for stocks differ dramatically from those of CONAB since Post uses a August/July marketing year.

Biotechnology

On March 17th, CTNBio legalized the planting and commercialization of a biotech cotton variety owned by Monsanto. The approval of the insect resistant BT variety was under deliberation by CTNBio since September with only the Ministry of Environment voting against planting and commercialization. It is not a surprise that CTNBio voted in favor of the use of biotech cotton given that in November the commission approved the sale of cotton seeds with 1 percent biotech material. However, it is surprising to some in the industry that the decision by CTNBio came so soon. The Brazilian Cotton Producer's Association (ABRAPA) was not expecting approval of biotech cotton for several months or even years.

The Ministry of Environment and environmental NGO's are opposed to the release of biotech cotton seed due to the possibility of crossing with native cotton species. However, CTNBio did require that Monsanto prepare an impact study on the effects of planting the seed. Furthermore, some regions are prohibited from planting biotech seed and buffer zones on cotton farms are required.

In addition to this approval, current requests by Monsanto and Bayer are pending for approval of additional biotech cotton varieties. Currently, input costs in Brazil are very high and insecticides comprise about 40 percent of the production costs for cotton with producers spaying up to 14 times a year. It is estimated that use of biotech seed with reduce the cost of production by U.S. $130 per hectare. Therefore, it is expected that adoption of this biotech variety will make cotton even more attractive to producers in Mato Grosso and Bahia versus corn and soybeans. Cotton area expansion for 2005/06 appears likely given that current domestic cotton prices on the rebound, good yields are expected, the recent WTO cotton case decision, and now this announcement by CTNBio. However, it is not clear that producers will be able to plant the seed this upcoming crop year. The new biotech seed must be registered with the Ministry of Agriculture following studies on the value of the use of the seed. It is expected that this study and registration could take up to two years and thus some in the industry do not expect the sale of biotech seed before 2007. Nevertheless, some producers believe they will be able to buy imported seed from the United States and Australia for use in the upcoming crop. However, it is not yet clear whether CTNBio with authorize the importation of such biotech seeds.