

THIS REPORT CONTAINS ASSESSMENTS OF COMMODITY AND TRADE ISSUES MADE BY USDA STAFF AND NOT NECESSARILY STATEMENTS OF OFFICIAL U.S. GOVERNMENT POLICY

Required Report - public distribution

Date: 9/1/2017

GAIN Report Number: CH17044

China - Peoples Republic of Cotton and Products Update

Chinese Imports Expected to Stay Stagnant Despite Recovery in Consumption

Approved By:

Michael Ward

Prepared By:

Jennifer Clever

Report Highlights:

Higher cotton prices in MY16/17 and continued government support to cotton production stimulated the recovery of Chinese cotton planted area in MY17/18, up 5.9 percent to 3.12 million hectares (MHa), over the previous year. In light of expected good yield, MY17/18 cotton production is forecast to grow 7.1 percent to 5.36 MMT. Cotton use is also expected to recover in MY17/18 to 8.38 MMT mainly due to the narrowing gap between domestic and global cotton prices. Increased cotton utilization is expected to reduce yarn imports. Correspondingly, MY17/18 ending stocks are forecast to decline to 8.64 MMT with stocks to use ratio down to 103 percent. The Chinese textile industry is still eager to use higher-grade foreign cotton to stay globally competitive. However, the expected sales of Chinese cotton reserves and the current restrictions on additional import quotas are unlikely to allow significant increases in imports. Hence, China's cotton imports are expected to remain stagnant in MY17/18 at 1.09 MMT.

Executive Summary:

Higher cotton prices in MY16/17 and continued government support to cotton production stimulated the recovery of Chinese cotton planted area in MY17/18, up 5.9 percent to 3.12 million hectares (MHa), over the previous year. In light of expected good yield, MY17/18 cotton production is forecast to grow 7.1 percent to 5.36 MMT. Cotton use is also expected to recover in MY17/18 to 8.38 MMT mainly due to the narrowing gap between domestic and global cotton prices. Increased cotton utilization is expected to reduce yarn imports. Correspondingly, MY17/18 ending stocks are forecast to decline to 8.64 MMT with stocks to use ratio down to 103 percent. The Chinese textile industry is still eager to use higher-grade foreign cotton to stay globally competitive. However, the expected sales of Chinese cotton reserves and the current restrictions on additional import quotas are unlikely to allow significant increases in imports. Hence, China's cotton imports are expected to remain stagnant in MY17/18 at 1.09 MMT.

China's MY17/18 Cotton Production is Expected to Recover to 5.36 MMT

Post's forecast for MY17/18 domestic cotton production is 5.36 MMT, up 7.1 percent from an estimated 5 MMT in MY16/17. The forecast recovery is based on a 5.9 percent expansion in planted area to 3.12 MHa, and based on slightly higher yield. Increase in cotton prices and profits during MY16/17, and the government's continued subsidies to Xinjiang province contributed to the cotton area expansion (see GAIN report CH17014).

Based on a July survey, the China Cotton Association (CCA) forecast for MY17/18 cotton production is 5.42 MMT, up 9.2 percent from MY16/17 and higher than its previous estimate of 5.37 MMT. Specifically by region, Xinjiang production is up 8.2 percent to 4.27 MMT, based on a 5.6 percent expansion in acreage and a 2.4 percent increase in yield compared to the previous year. Comparatively, forecast MY17/18 production for the Yangtze River and the Yellow River regions stand at 0.51 MMT and 0.55 MMT, respectively, both up by over 13 percent from MY16/17. However, total cotton area in the Yangtze River and Yellow River regions has declined to its lowest level since MY14/15. Hence, the recovery in cotton production in these regions is not expected to contribute significantly to the nation's overall cotton production.

The Chinese Ministry of Agriculture (MOA)'s August forecast for MY17/18 cotton production is 5.28 MMT, up 9.5 percent from MY16/17. The higher cotton production is a combination of a 6.2 percent acreage expansion and a 3.1 percent gain in yield compared to MY16/17.

As of the end of July 2017, major sources agree that weather conditions remained generally favorable for cotton growth in most of the cotton-growing regions. Impact of diseases and pests is reported as minimal. In Xinjiang, more than 65 percent of the interviewed farmers responded that the crop's growth is better than the previous year, 10 percentage points over that in MY16/17. The impact of high July temperatures on the cotton crops in the Yangtze River and the Yellow River regions appeared to be limited.

Cotton Production Estimate/Forecast by Various Sources (MMT; MHa)

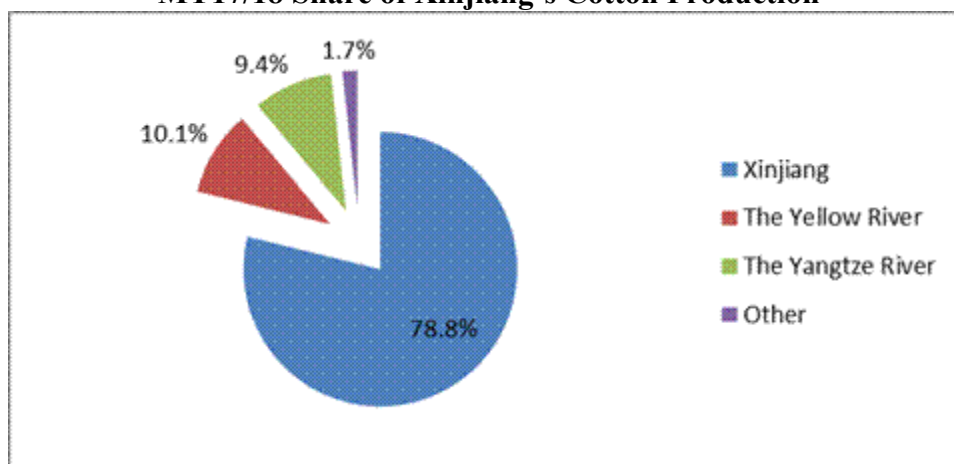
	CCA	MOA	NSB	Post
MY15/16 Acreage/Production	3.21/ 4.82	3.27/ 4.93	3.8/ 5.6	3.05/ 4.8
MY16/17 Acreage/Production	2.75/ 4.94	3.1/ 4.82	3.38/ 5.34	2.95/ 5.0
MY17/18 Forecast acreage/production	2.83/ 5.42	3.29/5.28	NA	3.12/ 5.36
MY17/18 production change	+9.7%	+9.5%	NA	+7.1%

CCA- China Cotton Association; MOA-China's Ministry of Agriculture; NSB – National Statistics Bureau

Xinjiang Cotton Production Faces Challenges

In MY17/18, Xinjiang's share of China's total cotton production increased and remains high at 78.8 percent. Xinjiang's dominant share is the direct result of the central government's support policy favoring cotton planting in this province along with lower profit margins for farmers in other cotton-planting regions. In addition, as production has decreased significantly in other cotton-planting regions, China's textile industry is increasingly reliant on Xinjiang cotton.

MY17/18 Share of Xinjiang's Cotton Production



Source: CCA 2017 August Report Data

Challenged by the rapid rise in labor costs, mechanized harvest is becoming increasingly popular throughout Xinjiang Province. This is particularly the case in the Xinjiang Production and Construction Corp (PCC) farms. Industry sources estimate that in MY16/17, about 90 percent of the PCC cotton area was harvested mechanically compared to 70 percent during the previous year. For non-PCC farms in Xinjiang, the rate of mechanized harvest remained relatively low in MY15/16 at 255,000 Ha, but still higher than 190,000 Ha in MY13/14. The increasing trend towards mechanization is expected to continue in MY17/18 and beyond.

However, based on inspection results in MY16/17, the Xinjiang Fiber Inspection Bureau reported new challenges for Xinjiang cotton. Cotton quality is impacted by the large number of cotton varieties currently planted in Xinjiang. Mechanized harvest of different varieties with various maturation times and other traits resulted in poor uniformity and high trash content. Xinjiang cotton trash content is reportedly up to 2 percent. Hence, ginners' excessive trash removal treatment contributed to deterioration in fiber length and strength. China's textile sector complained that the losses in pre-

spinning mechanized harvested Xinjiang cotton are higher than those from imported U.S. cotton. Notwithstanding, overall, MY16/17 Xinjiang cotton quality has improved compared to the last three years when the government purchased most of the cotton for state reserves and farmers cared primarily about yield. It will take some time for the Xinjiang cotton sector to develop more adequate technology for mechanized harvest to fully upgrade the overall productivity of its cotton farming. This includes utilizing appropriate cotton varieties and adopting better agronomical practices.

Stocks

Chinese cotton stocks are forecast to fall dramatically to 8.64 MMT by the end of MY17/18 compared to 10.6 MMT at the end of MY16/17. Increased use of state reserves and the moderate recovery in cotton consumption accounted for the fall. In addition, the forecast limited cotton imports, as a direct result of restrictions on additional import quotas, will also contribute to ending stocks falling in MY17/18.

The 2017 government's cotton reserve sales began on March 6 and were initially scheduled to temporarily suspend at the end of August. However, the government has extended the sales to continue until the end of September in order to further reduce reserve stocks. Similar to 2016, the basic auction price is market-oriented (not fixed) and based on the average between the domestic and international spot market cotton price indexes during the previous week. The daily volume for auction will be about 30,000 tons. As of August 18, 2017, the cumulative cotton purchased reached 2.4 MMT and accounted for 68.3 percent of total offered volume. CCA estimates that the total volume sold by the end of September could reach 3 MMT, reducing the state cotton reserve to about 5.5 MMT. This would be considered a more manageable level compared to the 13.9 MMT in MY14/15, when China's cotton reserves peaked after three years of state supported purchase programs. ([See GAIN Report CH15011](#))

Cotton Trade

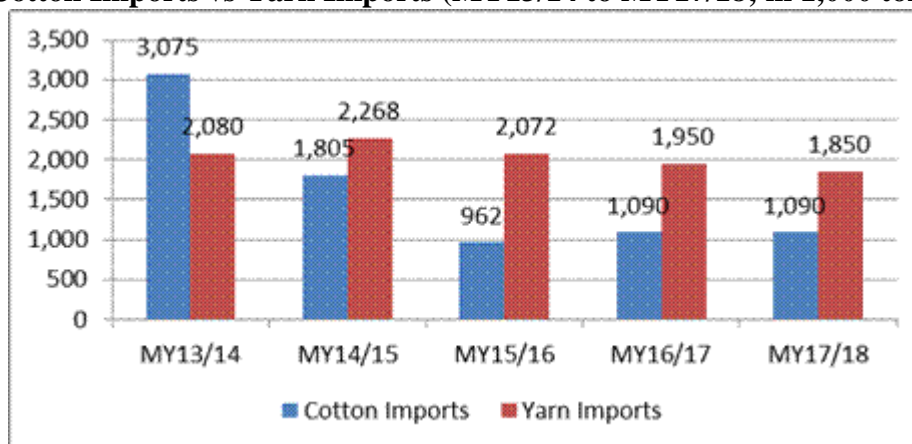
Cotton imports expected to be 1.09 MMT in MY17/18

Despite the narrowing gap between Chinese and international cotton prices, and the expected fall in yarn imports, MY17/18 cotton imports are forecast to stay unchanged from MY16/17 at 1.09 MMT. The Chinese textile industry continues to seek higher-grade cotton from foreign suppliers to stay competitive in export markets. However, the government's restriction on additional quota imports (subject to a sliding duty), outside the tariff rate quota amount committed under the World Trade Organization (WTO), temper the prospects for any significant increases in cotton imports. The WTO quota allows a yearly volume of 894,000 tons subject to a one percent import tariff. Industry observers comment that the issuance of additional quotas appears improbable for 2017.

Anecdotal news stating that the government might consider special approval for imports of high-grade cotton to improve the mix of the state cotton reserve has circulated since July 2017. Trade data shows cotton imports from the United States are likely to hit a half million tons (high-grade cotton) in MY16/17 given that the WTO TRQ is only 894,000 tons per year. A relatively large Xinjiang crop of "higher" grade cotton could partially meet the industry demand in MY17/18. Liberalized yarn imports can also alleviate the shortage of high count yarn for fabric manufacturing. According to industry data,

the Chinese textile sector recovered during the first half of 2017. In consideration of all these factors, it is unclear how and when the government will justify additional cotton imports specifically for state cotton reserve. However, given the government's traditional role in regulating the cotton market, any form of government intervention should not be surprising.

Cotton Imports vs Yarn Imports (MY13/14 to MY17/18; in 1,000 tons)



Source: Global Trade Atlas (MY16/17 estimate and MY17/18 forecast by FAS/Beijing)

Yarn imports have been an important factor exerting downward pressure on cotton imports in recent years. Unlike cotton imports, yarn imports do not face quota restrictions. High yarn imports partly lowered cotton imports in 2015 and 2016. However, the current small price gap between domestic and international cotton prices of about RMB1,200 (\$176)/ton is expected to reduce the profitability of yarn imports. The Forecast decline in yarn imports is expected to facilitate stable cotton imports in MY17/18.

U.S. cotton continues to compete with other suppliers for China's limited import quotas

Chinese imports of U.S. cotton are expected to recover to about 490,000 tons in MY16/17 after falling to their lowest level in 14 years at 192,000 tons in MY15/16. Although the quality and reliability of U.S. cotton appeals to China's end-users, in MY15/16, Australian cotton became very competitive and topped China's market with 268,000 tons. Chinese imports of U.S. cotton are likely to stabilize at 500,000 tons in MY17/18 given Chinese buyers' preference for high-grade cotton when import quotas are limited.

Chinese cotton exports remains insignificant

China's cotton exports average about 10,000 tons annually, a nominal amount compared to China's total cotton use. Given the relatively low quality at a high price, sporadic cotton exports are likely in 2017 and beyond but are expected to remain insignificant.

MY17/18 Cotton Consumption Expected to Grow to 8.38 MMT

MY17/18 cotton consumption is forecast at 8.38 MMT, up from an estimated 8.16 MMT in MY16/17. The growth in cotton use is mainly driven by a more market-oriented domestic cotton price,

which is expected to reduce yarn imports and stimulate cotton fiber use in yarn production. Anticipated growth in domestic demand for textiles and apparel is also expected to moderately boost China's cotton consumption. Chinese exports of textile and apparel are expected to remain stable.

Forecast lower yarn imports will stimulate China's cotton consumption. In previous years, increased yarn imports significantly reduced China's cotton use for spinning. The average net yarn imports hit 1.8 MMT per year from MY14/15 to MY15/16 compared to 0.5 MMT per year from MY09/10 to MY10/11. Industry sources indicate that the current gap between the domestic and international cotton prices (at about RMB1,200 or \$176/ton compared to the RMB2,000 or \$300/ton in October 2016) will encourage more domestic spinning. Cotton utilization in yarn production is expected to continue recovering in MY17/18 in response to a more market-oriented cotton price.

According to NSB, in the first half of 2017, China's textile production continued its steady recovery with yarn production increasing by 5.1 percent, fabric production by 4.5 percent and apparel production by 1.9 percent compared to the previous year. Additionally, total investment in the textile sector increased 9.1 percent from the previous year.

It is worth noting that textile investment in Xinjiang soared to RMB48 billion (\$7 billion) in 2016 from the RMB9.6 billion (\$1.4 billion) in 2014. Total spindles are expected to reach 16 million by the end of 2017, up from 7 million in 2014. Total yarn production is likely to reach 1.5 MMT in 2017, consuming 1.4 MMT of cotton roughly one third of Xinjiang's cotton production. By comparison, in 2016, total yarn production was 1.13 MMT and cotton use was about 1 MMT. Xinjiang's favorable policies, including tax reductions, and favorable power prices will continue to attract more investment in the textile and apparel industry in 2018 and beyond.

Exports of textiles and apparel expected to stabilize

Chinese Customs' data shows that during the first half of 2017, total Chinese textile and apparel exports were up 2.2 percent from the previous year and valued at \$124 billion. Despite a slight decline in China's share in key textile markets such as the United States, Japan and the European Union, Chinese exports to the "One Belt and One Road" region increased by 0.9 percent. Chinese textile and apparel exports to Africa rose 4.1 percent and hit \$9.4 billion (equivalent to the total export value to Japan). Given the more competitive domestic cotton price, Chinese industry experts remain optimistic about the prospects for stable exports in 2017.

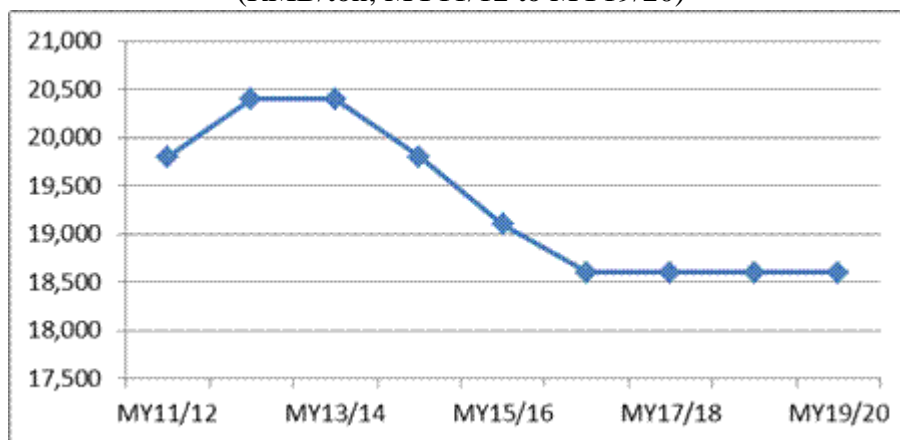
Growth in domestic demand for textile and apparel drives cotton use

China's overall increase in demand for textile and apparel products is fueled by higher disposable income, rising living standards, population growth, and urbanization.

During the first half of 2017, China's economic growth reached 6.7 percent. According to Chinese industry statistics, total domestic sales value of apparel and other textile products increased 7.3 percent; the total textile sector's output value increased 9.6 percent; the sector's profits increased 11.6 percent compared the same period in 2016. All these indicators suggest a steady recovery of the Chinese textile industry and support more cotton use in MY17/18.

Policy

China Cotton Support Policy Evolution
(RMB/ton; MY11/12 to MY19/20)



Note: MY11/12 to MY13/14 is government purchase floor price;
MY14/15 to MY19/20 is “target price” for Xinjiang only; Source: NDRC

The fixed “Target Price” (at RMB18,600 or \$2,776/ton) for Xinjiang from 2017 to 2019 is expected to stabilize cotton acreage in Xinjiang. The MY17/18 implementation of the target price-based subsidy in Xinjiang is expected to stay unchanged from MY16/17. In general, Xinjiang farmers welcome this policy as it provides predictability and assures the basic farming profits. However, as of this report, there is no official announcement for the fixed subsidy (RMB2,000 or \$313/ton) for the other nine cotton-producing provinces.

Tables

Production, Supply and Demand (PSD)

Table 1. PSD (in 1,000 Bales and 1,000 Ha)

Cotton China	2015/2016	2016/2017	2017/2018
--------------	-----------	-----------	-----------

	Market Year Begin: Aug 2015		Market Year Begin: Aug 2016		Market Year Begin: Aug 2017	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Area Planted	0	3,050	0	2,950	0	3,125
Area Harvested	3,050	3,050	2,900	2,950	3,125	3,125
Beginning Stocks	66,920	66,920	58,198	58,198	48,398	48,618
Production	22,000	22,000	22,750	22,970	24,500	24,600
Imports	4,406	4,406	5,000	5,000	5,000	5,000
MY Imports from U.S.	0	880	0	2,250	0	2,300
Total Supply	93,326	93,326	85,948	86,168	77,898	78,218
Exports	128	128	50	50	50	50
Use	35,000	35,000	37,500	37,500	38,500	38,500
Loss	0	0	0	0	0	0
Total Dom. Cons.	35,000	35,000	37,500	37,500	38,500	38,500
Ending Stocks	58,198	58,198	48,398	48,618	39,348	39,668
Total Distribution	93,326	93,326	85,948	86,168	77,898	78,218
Stock to Use %	165.67	165.67	128.89	129.48	102.07	102.9
Yield	1,570	1,570	1,708	1,695	1,707	1,714
TS=TD	0	0	0	0	0	0

Table 2. PSD (in 1,000 Tons and 1,000 Ha)

Cotton China	2015/2016		2016/2017		2017/2018	
	Market Year Begin: Aug 2015		Market Year Begin: Aug 2016		Market Year Begin: Aug 2017	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Area Planted	0	3,050	0	2,950	0	3,125
Area Harvested	3,050	3,050	2,900	2,950	3,125	3,125
Beginning Stocks	14,570	14,570	12,671	12,671	10,537	10,537
Production	4,790	4,790	4,953	5,001	5,334	5,356
Imports	959	959	1,089	1,089	1,089	1,089
MY Imports from U.S.	0	192	0	490	0	501
Total Supply	20,319	20,319	18,713	18,761	16,960	17,030
Exports	28	28	11	11	11	11
Use	7,620	7,620	8,165	8,165	8,382	8,382
Loss	0	0	0	0	0	0
Total Dom. Cons.	7,620	7,620	8,165	8,165	8,382	8,382
Ending Stocks	12,671	12,671	10,537	10,537	8,567	8,637
Total Distribution	20,319	20,319	18,713	18,761	16,960	17,030
Stock to Use %	165.67	165.67	128.89	129.48	102.07	102.9
Yield	1,570	1,570	1,708	1,695	1,707	1,714
TS=TD	0	0	0	0	0	0