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Cotton and Products Update

August Lockup Report

Approved By:

Michael Riedel

Prepared By:

Jennifer Clever and Wu

Xinping

Report Highlights:

Post's MY14/15 forecast for cotton production remains unchanged from the previous 6.5 million tons.

According to several leading industry sources, a change in the government's support policy may have reduced the cotton planting area in cotton-producing provinces (except Xinjiang). However, as of this publication, the current available data is insufficient to support an adjustment to Post's recent forecast. As of late MY13/14, government cotton purchases over the past three years have built domestic stocks to a record high of 13.4 million tons. The government's plan to reduce high stocks, coupled with a slight recovery in consumption to 8.1 million tons, will reduce cotton imports to about 1.7 million tons in MY14/15. U.S. cotton exports to China will fall further in MY14/15 from the 638,000 tons level in MY13/14.

Executive Summary:

Post's MY14/15 forecast for cotton production remains unchanged from the previous 6.5 million tons. According to several leading industry sources, a change in the government's support policy may have reduced the cotton planting area in cotton-producing provinces (except Xinjiang). However, as of this publication, the current available data is insufficient to support an adjustment to Post's recent forecast. As of late MY13/14, government cotton purchases over the past three years have built domestic stocks to a record high of 13.4 million tons. The government's plan to reduce high stocks, coupled with a slight recovery in consumption to 8.1 million tons, will reduce cotton imports to about 1.7 million tons in MY14/15. U.S. cotton exports to China will fall further in MY14/15 from the 638,000 tons level in MY13/14.

Production

China's MY14/15 domestic production will fall to 6.5 million tons

China's MY14/15 domestic production will fall to 6.5 million tons based on planted area of 4.35 million hectares (MHa). A change in the government's support policy lowered farmers' profit expectations and thus reduced the planted area, particularly in the Yellow River and Yangtze River region. In Xinjiang, however, the estimated strong positive profits of MY13/14 (likely higher or similar to those in MY12/13 of RMB8,820 or \$1,420/Ha), together with government's direct subsidy to farmers (based on target price of RMB19,800/ton) has stabilized cotton planted area in MY14/15.

As the MY14/15 crop harvest approaches, major industry sources have published recent production survey results ranging from 6.2 million tons to 6.75 million tons. However, all sources agree that cotton planted area in the Xinjiang region remains stable, or may even be slightly up from the previous year. Conversely, the production area in all other provinces declined in response to the elimination of the government's price support to these regions. The difference in production estimates largely stems from the different regions used as a basis (Xinjiang vs. all-other provinces).

Cncotton.com's August report showed the MY14/15 cotton planted area fell to 4.02 million hectares, down 15 percent (or 689,000 Hectares) from the previous year. Considering a general stable area and higher yield in Xinjiang, the MY14/15 production is estimated at 6.22 million tons, down 11 percent (or 800,000 tons) over the previous year.

However, according to its July survey, the Rural Economic Research Center of Ministry of Agriculture (MOA) estimated MY14/15 cotton production at 6.4 million tons based on a fall in the nation-wide area of 8.7 percent, contrasted by an increase of 5.2 percent in Xinjiang.

On August 27, the China Cotton Association (CCA) published its July survey results which show MY14/15 production at 6.73 million tons based on planted area of 2.27 MHa for the Xinjiang area and 1.96 MHa for all-other provinces. CCA explained that the Xinjiang planted area is based on the recent official survey which included additional area previously not included in official statistics. The production estimate for Xinjiang is based on July's adequate sunlight and temperatures which has

facilitated crop growth and will likely boost yield. In contrast, a 22.7 percent area decline in all other providences (19.5 percent decline in the Yangtze River and 26.7 percent in the Yellow River region) is expected to reduce their total production to 2.13 million tons.

	Total Nation		--Xinjiang		--All Other	
	Area	Production	Area	Production	Area	Production
MY13/14	4,662	7,000	2,126	4,180	2,536	2,820
MY14/15	4,227	6,730	2,267	4,600	1,960	2,130

Note: in 1000 Ha and 1,000 tons

As of late August, the weather conditions in Xinjiang remain favorable for cotton growing and maturing. Conversely, based on a National Cotton Exchange's mid-August survey, 39 percent of the cotton in the Yangtze and Yellow river regions is rated as better than the previous year, 34 percent is rated as similar, and 27 percent is rated not as good. Harvest in these regions is expected to take place during the first half of September, slightly later than normal.

China's MY13/14 production was estimated at 7 million tons

China's MY13/14 production was estimated at 7 million tons unchanged from previous data. As of August 22, the China Fiber Inspection Bureau (CFIB) data shows MY13/14 total classified volume hit 7.41 million tons, of which 4.72 million tons were produced in Xinjiang. As reported by many industry sources, the CFIB data may be over estimated by "repeated classification" in order to qualify for state reserve's high floor price. Industry source estimated the "repeated classification" rate exceeded 10 percent in Xinjiang in MY14/15. The government purchase of MY13/14 crop was estimated at 6.58 million tons, of which 4.28 million tons were Xinjiang cotton, and the remaining 2.3 million tons were from other provinces.

New developments in Xinjiang cotton production

-An official survey of the cotton planted area is currently in progress to facilitate the implementation of direct support payments to farmers. Implementation remains a challenge as support is given to each individual farmer. Although the subsidy is most likely to be production based, the marginal area not included in official statistics may be reported in this survey in order to qualify for the subsidy. Anecdotal news highlight that the survey shows a significant increase in the cotton area to 2.67 MHa, compared to the CCA area of 2.27 MHa, and the NSB's average of 1.8 MHa. Currently, it is hard to assess the reliability of the area changes and how it will impact production estimates for MY14/15 and beyond.

-With the government's support, production is expected to increase further from the current average of 4.5 million tons per year.

-The promotion of machine-based harvest will improve cotton productivity and reduce production cost by an estimated RMB 1,200/ton. Currently, machine-based harvest is mainly done in the farms owned by the Xinjiang Production and Construction Corp, an estimated 1.5 million tons. However, a lot of work and investment is still needed to increase technology and extend the use of machines to harvest cotton to the whole Xinjiang region.

-Cotton quality declined in the last 3 years due to high floor prices set by state purchases. This encouraged farmers to focus on yield only at the expense of meeting textile sector's quality requirements such as fiber length, strength, etc.

Government subsidy policy details expected

As of this report, outside of the announced target price of RMB19,800/ton, the details on the direct subsidy policy to Xinjiang cotton farmers based on target price have not yet been announced.

Whether the government will support cotton farmers in the Yellow and the Yangtze River region remains unknown. This is expected to re-shape China's cotton production as farmers' net revenue from cotton in these regions will no longer be positive, as the basic wage per labor/day for cotton-farming will likely fall below the wage for non-farm casual work. Given the low cotton productivity in these regions, by eliminating the support policy (or with limited direct support to regions where farmers' have limited options to grow other crops), the government seems to encourage farmers to phase out small scale and small yield cotton planting. Meanwhile, a comprehensive support policy to Xinjiang's cotton sector is expected to enhance a moderate domestic cotton production level to a level that meets domestic textile demands. Based on this assumption, U.S. cotton exports to China remain optimistic in the long term, although challenged by cotton from India and other major suppliers.

In a report issued by China's National Development and Reform Commission (NDRC) dated August 4, the average cotton selling price in the first half of 2014 was RMB17,414/ton, down 9.8 percent from the previous year. NDRC requested a wide publication of the new subsidy policy in Xinjiang to stabilize the cotton area.

Marketing

While the growth of MY14/15 crop was generally normal, cotton harvest may be one week later than usual due to low April temperatures and strong winds in southern Xinjiang. Industry leaders remain very cautious in processing/trading MY14/15 domestic cotton because of this year's price uncertainty. Thus, farmers may face difficulty in selling seed cotton. Cotton traders are frustrated on what price should be offered to farmers for seed cotton given the different price indicators (including target price, auction price, Zhengzhou Futures Market price and spot market price, and the international market price). The government's selling of reserve stocks will stop at the end of August. Some industry leaders estimate that the government's auction price might be a relevant indicator for formulating the seed cotton purchase price.

Consumption

MY14/15 cotton consumption is forecast at 8.1 million tons, up from an estimated 7.6 million tons in MY13/14. Textile and apparel demand in developed markets, like the United States and EU, is expected to recover moderately in response to the recovering economic environment. Similarly, demand for textile and apparel products in China and other developing countries is also expected to rise.

On the other hand, industry experts anticipate that the share of synthetic fibers and other fibers in cotton yarn production may fall moderately in the second half of 2014 due to the declining domestic cotton price.

Cotton yarn imports are expected to stabilize and boost domestic cotton use. China's strong annual cotton imports in MY13/14, about 2 million tons, reduced the use of domestic cotton. However, the price advantage for imported yarn declined as a result of China's adjusted domestic cotton stocks selling-price down to RMB17,250/ton. Given that the price for MY14/15 domestic cotton will be more market-oriented, cotton yarn imports are expected to level off in response to China's cotton selling price change in MY14/15. Smaller imports of yarn will likely encourage more use of domestic cotton. Industry insiders believe Chinese spinners can afford to pay RMB2,000/ton more for cotton while staying competitive in the yarn market.

As indicated in the following table, National Statistics Bureau's data show total yarn production in the first half of 2014 increased by 8.7 percent from the previous year.

China's Textile Sector Production/Investment Trends

Year/Item	2011	2012	2013	2014(Jan-Jun)	2014/2013 Change %
Yarn Production (million tons)	28.7	29.84	32.0	18.47	+8.7
Fabrics Production (billion meters)	81.4	84.1	88.3	33.4	+3
Chemical Fiber Production (million tons)	33.9	38	41.2	21.37	+7.5
Fixed Asset Investment in Textile Sector (RMB billion)	366.9	397.1	NA	NA	NA

Source: China Economic and Social Development Report by NSB
(Exchange Rate: 2012-\$1=RMB6.3; 2013-\$1=RMB6.2; 2014-\$1=RMB6.2)

China's textile and apparel exports increased to \$132.5 billion, up 4.1 percent over the previous year. Industry insiders expect the textile sector to see a stable development in the second half of 2014 if world demands continue to recover and the price for domestic cotton becomes more market-oriented.

Domestic yarn spinning and yarn imports

Industry sources indicated that China's current total spindles are estimated at 115 million, accounting for 47 percent of the world's total. Increasing production costs in particular for cotton and labor is reducing China's yarn spinning competitiveness. As long as cotton imports are controlled by quotas, any significant improvement in domestic cotton productivity is not realistic. Labor and electricity costs continue to rise. Other competing yarn producers such as India and Vietnam have shown advantages. In the long-term, some industry insiders believe cotton yarn imports will remain on growing. How China's spinning industry evolves in the next few years will mostly depends on China's policy on cotton production and imports.

Stocks

At the end of MY13/14, government purchases of more than 6.58 million tons of the MY13/14 cotton crop raised state-held reserves to a record level estimated at 13.4 million tons, a sizeable increase from an estimated 11 million tons in beginning stocks.

Post forecasts ending stocks will remain above 13 million tons at the end of MY14/15, depending on the consumption recovery rate and the price gap between the domestic and international market. In MY14/15 the stock to use ratio remains high at above 160.

Record high stock levels prompted government auctions of state reserve cotton but the response has been lackluster. As of August 22nd, the government had only sold 2.53 million tons of reserve cotton, around 20 percent of the volume offered for sale, despite the lower selling price adjusted down to RMB17,250/ton from the previous RMB18,000/ton price. This reaction reflects the textile sector is taking a “wait and see” approach to manage price uncertainty.

The auction was scheduled to stop at the end of August when the MY14/15 new crop enters market. Reducing state reserve stocks to an appropriate level will remain a challenging task in MY14/15 and beyond.

Cotton Trade

MY14/15 cotton imports are forecasted down significantly to 1.7 million tons from the 3.1 million tons in MY13/14 as China is expected to expedite the release of state reserve cotton to an appropriate level in late MY14/15. Imports, however, will depend on the balance between many factors, including the size of domestic production, strength of cotton consumption, and the price gap between domestic and world prices.

Note: 2014 Exchange rate \$1=RMB6.2

Tables

Production, Supply and Demand (PSD)

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

Cotton China	2012/2013		2013/2014		2014/2015	
	Market Year Begin: Aug 2012		Market Year Begin: Aug 2013		Market Year Begin: Aug 2014	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Area Planted	0		0		0	
Area Harvested	5,300	5,300	4,900	4,900	4,350	4,350
Beginning Stocks	31,081	31,081	50,361	50,361	61,411	61,526
Production	35,000	35,000	32,000	32,000	29,500	29,855
Imports	20,327	20,327	13,600	14,125	8,000	7,810
MY Imports from U.S.	0		0		0	
Total Supply	86,408	86,408	95,961	96,486	98,911	99,191
Exports	47	47	50	50	50	50
Use	36,000	36,000	34,500	34,910	36,500	37,210
Loss	0		0		0	
Total Dom. Cons.	36,000	36,000	34,500	34,910	36,500	37,210
Ending Stocks	50,361	50,361	61,411	61,526	62,361	61,931
Total Distribution	86,408	86,408	95,961	96,486	98,911	99,191
Stock to Use %	140	140	178	176	171	16
Yield	1,438.	1,438.	1,422.	1,422.	1,477.	1,494.
TS=TD		0		0		0

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

Cotton China	2012/2013		2013/2014		2014/2015	
	Market Year Begin: Aug 2012		Market Year Begin: Aug 2013		Market Year Begin: Aug 2014	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Area Harvested	5,300	5,300	4,900	4,900	4,350	4,350
Beginning Stocks	6,767	6,767	10,965	10,965	13,371	13,396
Production	7,620	7,620	6,967	6,967	6,423	6,500
Imports	4,426	4,426	2,961	3,075	1,742	1,700
MY Imports from U.S.	0	0	0	0	0	0
Total Supply	18,813	18,813	20,893	21,007	21,535	21,596
Exports	10	10	11	11	11	11
Use	7,838	7,838	7,511	7,601	7,947	8,101
Loss	0	0	0	0	0	0
Total Dom. Cons.	7,838	7,838	7,511	7,601	7,947	8,101
Ending Stocks	10,965	10,965	13,371	13,396	13,577	13,484
Total Distribution	18,813	18,813	20,893	21,007	21,535	21,596
Stock to Use %	140	140	178	176	171	166
Yield	1,438	1,438	1,422	1,422	1,477	1,494
TS=TD	0	0	0	0	0	0