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## **China - Peoples Republic of**

### **LOCK-UP REPORT**

#### **Cotton and Products Update**

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**Report Highlights:**

MY11/12 domestic cotton production is forecast at 7.3 MMT, down from the previous forecast of 7.38 MMT due to yield losses following September rains in some cotton-producing regions.

MY11/12 cotton consumption is forecast to fall slightly from 10MMT in MY 10/11 to 9.9 MMT.

MY11/12 cotton imports are forecast at 3 MMT, up from 2.6 MMT in the previous year. MY12/13 domestic cotton planting is likely to decline as farmer's switch to higher profit crops, particularly in the Yellow River region in MY11/12.

**Post:**  
Beijing

**Executive Summary:**

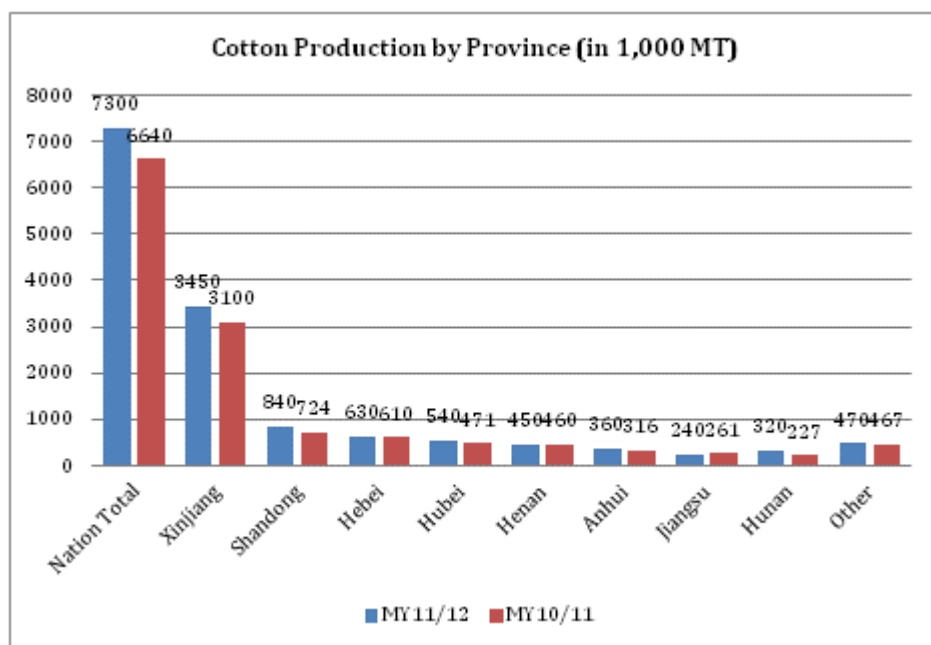
MY11/12 domestic cotton production is forecast at 7.3 MMT, down from the previous forecast of 7.38 MMT due to lower than expected yields following rainy weather in some cotton-producing regions in September. Forecast MY11/12 cotton consumption is 9.9 MMT, down from the 10 MMT in MY10/11 mainly due to slow demand recovery for textile products by major importing regions although domestic demand continues to grow. MY11/12 cotton imports are forecast at 3 MMT, up from the 2.6 MMT in the previous year. Domestic cotton planting is likely to be challenged by other crops in MY12/13 as surveys shows farmer's income from cotton is disadvantaged in particular in the Yellow River region in MY11/12. Governmental policy on cotton production and trade remains unchanged.

**MY11/12 domestic cotton production forecast at 7.3 MMT**

The November forecast for MY11/12 domestic cotton production is 7.3 MMT, down 80,000MT from September's forecast. The drop reflects lower yields due to extended rainy days in the Yellow River region (including Shandong, Hebei and Henan Provinces etc) and some parts of the Yangtze River region, with industry production forecasts ranging from 7.2 MMT to 7.55 MMT.

The China Cotton Association (CCA) November forecast remains unchanged from the previous month at 7.28 MMT based on planted area of 5,345,500Ha. China's Ministry of Agriculture (MOA) projects 7.2 MMT based on its agricultural information network. China State Cotton Reserve Corporation (Cncotton.com) adjusted its forecast to 7.55 MMT from its September data of 7.85 MMT, down 3.8 percent, with estimated planting area unchanged at 5,295,000 Ha. More specifically, production is forecast at 2.43 MMT in the Yellow River region (down from September data 2.62 MMT), up 21 percent over the previous year; 1.55 MMT production for the Yangtze River region (down from September data 1.62 MMT), up 19.6 percent over the previous year; 3.55 MMT for the Northwest region (slightly lower than the September data of 3.59 MMT), up 21.8 percent over the previous year.

According to China's Meteorological Report, the Yellow River region received, on average, 77 fewer hours of sunlight and 71 mm more rainfall in September, with a temperature 1-4 degrees centigrade lower than normal, causing a deterioration in quality. Parts of the Yangtze River region temperature and sunlight hours were also lower than normal impacting cotton maturation and weight of the cotton balls. The weather condition in Northwest remained "good," generally favorable for cotton maturation and harvest from September. During October and November, the weather conditions were reportedly good in most cotton-producing regions with adequate sunlight and temperature facilitating cotton harvest and transport. The following chart shows Post estimates of China's Domestic Cotton Production by Major Provinces in MY10/11 and MY11/12 (in 1,000 MT).



### Marketing of MY11/12 cotton remained slow

The harvest of MY11/12 crop has been generally smooth. Cncotton.com reported that as of November 11, the harvest was 87.8 percent complete. According to industry sources, as of November 21, the harvest rate reached 82 percent in North Xinjiang but only 75 percent in South Xinjiang, 100 percent in Shandong and Hebei, 90 percent in Hunan, and 88 percent in Anhui. Industry insiders report that due to shortages of labor and increases in labor costs, machine harvesting in Xinjiang increased moderately and expedited the harvest pace (estimated to account for 14 percent of total production). But mechanized harvesting benefits are accompanied by losses not faced by hand picking, contamination of left-over plastic sheeting and higher percentages of short fiber content.

The marketing of the crop, however, remains slow as farmers' high expectation for seed cotton price contrasts with ginners/traders cautious approach due to their thin to negative profits. Currently, the government's suggested seed cotton price stands at about RMB8.5/Kg (which converts to grade 328 cotton price at RMB19,800/MT), however, the ginning profit could be negative based on the current seed cotton price. Cncotton.com's survey indicates, as of November 11, the seed cotton marketing rate and the ginned rate stood at 66.4 percent and 50.4 percent, down 6.7 and 11.4 percent respectively, from the most recent four year's average, while the marketing of ginned cotton was 25.5 percent, 3.9 percent higher than the recent four's average somehow driven by the "State Purchase for Reserve" program started in October. As of November 22, total purchase for state reserve reached 738,810 MT, of which 523,680MT is Xinjiang origin and 215,130MT from other provinces. Despite the government's policy of "purchase without volume limit", the smaller than planned daily purchasing volume indicates the current marketing pace remained slow. The increased production cost, coupled with yield decline, in particular in the Yellow River region, continues to slow the marketing pace of the MY11/12 crop. The state reserve purchased cotton is tentatively stored in local warehouses. Xinjiang Railway Authority reported that the planned 210 railcars per day (capacity of 9,030 MT roughly) for shipping cotton

fell short of this target due to demands from other transport loads such as fertilizer.

On November 11, China's National Development and Reform Commission (NDRC), in collaboration with other seven agencies, published Notice on Promoting Marketing of MY11/12 Domestic Cotton, which requires promoting marketing of the crop by all relevant agencies to be of great significance for maintaining a stable cotton production.

Based on China Fiber Inspection Bureau (CFIB), as of November 22, total CFIB classified volume reached 2,243,298 MT (Xinjiang – 1,790,785 MT and others – 452,213 MT). The cotton classification program (introducing large bales and phasing out small bales completely in 2010) is challenged by the scattered small-scale household farming and some spinning mills preference for the smaller bales at lower cost.

### **Cotton planting likely to be disadvantaged in MY12/13**

Despite the government's efforts to set a pre-harvest floor price to secure favorable returns, farmers are generally unsatisfied with the current purchasing price for seed cotton which ranges from RMB7 to 8.5 per kilogram based on the grades. According to Hebei Cotton Association, the total output value is estimated at RMB25,200 per hectare based on farm-gate seed cotton price of RMB8 per kilogram and an estimated yield of 3,150 Kg per hectare. This output value is even lower than the total costs for physical inputs and the minimum 300 labor days per hectare. For rented land (at an estimated fee of RMB5,625 per hectare), the average per hectare loss is estimated at RMB1,425. Dezhou and Shandong cotton associations also report lower cotton profit compared to grains (with lower labor costs) and casual work in cities. In Tianjin, four large cotton farmers, with 267 hectares of rented land for cotton, complained that they would lose \$950/Ha based on the declined yield (down 33 percent) and the current seed cotton price (down 33 percent from the previous year). China's industry leaders argue that, if the government wants to maintain a stable cotton planting area, the floor price ratio between grain and cotton should be 12 to 1 instead of the current estimated 10 to 1 based on the production costs of grain and cotton.

### **MOA vows to maintain domestic annual cotton production at above 7 MMT**

In the recently published "The 12<sup>th</sup> Five Year Plan for Crops Plantation", MOA set a target to maintain annual cotton production above 7 MMT based on planted area of 80 million Mu (5,333,000Ha) to meet the domestic demands for cotton textile products. Maintaining a reasonable cotton price and profit for farmers remains key to stable cotton production. More specific measures include stable production areas in the Yellow and Yangtze River Regions, boosting Xinjiang area (24 million Mu); increasing yield through technical extension/innovation in water management, including increasing coverage of drip irrigation and plastic film covering in Xinjiang; promoting new varieties such Bt and high quality cross bred varieties and modest increases in planting density; promoting mechanized farming to improve efficiency.

### **MY11/12 cotton consumption growth remains stagnant**

China's cotton consumption in MY10/11 was estimated at about 9.9 MMT, down from the 10 MMT in the previous year mainly due to lower demands from major overseas cotton textile importing regions. The price fluctuation since the third quarter of 2010 also led to a decline in cotton share

and consumption in MY10/11. Many spinning mills, in particular the small to medium ones, were forced to suspend full or part operations to manage risks when the yarn spinning profit fell to zero or negative. This situation has not shown significant improvement in the first few months of MY11/12. In an effort to reduce production costs, many mills opted to substitute fibers in the past months (polyester, viscose, flax, bamboo etc), and currently many mills are still trying hard to use their high priced cotton and yarn stocks purchased and processed at high prices. In Henan, the local industry survey shows high yarn stocks for mills, with the highest stocks reaching two months.

According to China's National Statistics Bureau (NSB), yarn production for the first three months of MY11/12 was 7.7 MMT, up 5.4 percent over the same period in the previous year, and lower than the 8.8 percent growth rate in MY10/11. China's industry data show that from January to August, total textile and garment export volume increased merely 2%, although value increased 25 percent over the previous year. The textile and garment export value in September fell by 9.7 percent over August. Orders from overseas markets remained weak for the traditional high season of Christmas and New Year. In addition to the appreciation of Chinese currency, other production costs continued growing including labor, power, environment and capital. The government's tight financial policy is squeezing small to medium scale mills in their search for capital. Although China's domestic textile consumption maintains steady growth in concert with continuing high GDP growth in MY10/11 and expected growth in MY11/12, cotton consumption in MY11/12 is likely to fall from the previous year.

#### **MY11/12 cotton imports are forecast at 3 MMT**

Post forecast MY11/12 cotton consumption at 3 MMT, up from the 2.6 MMT in the previous year. This is based on the estimated supply gap for MY11/12 and expected imports to replenish the state cotton reserve stocks which were estimated to have fallen to 200,000 MT at the end of MY10/11. Many industry insiders predicted that the government would add reserve stocks to a level ranging from 2 to 3 MMT to match normal cotton consumption demand. Anecdotal news reported that China's Cotton Reserve Corporation purchased 800,000 MT of imported cotton and will likely add another 200,000 MT before the end of 2011. NDRC and CCA forecasted the supply gap at about 2.8 MMT in MY11/12 and believe this will continue in the long term. Domestic cotton production is unlikely to sustain its level with limited land available for cotton and a governmental priority for food security production. Cotton price fluctuation, coupled with higher production cost/risks, adds more uncertainty to cotton planting area. However, the huge textile capacity of over 120 million spindles (accounting for 50% of world total) continues to drive cotton consumption and boost imports in the long term. Some cotton imports for export-oriented processing are likely to be impacted by the lower demands from major textile importing markets.

China's relevant ministries, in collaboration with China Textile Industry Association, formulated the 12<sup>th</sup> Five-Year (2011-2015) Plan for Cotton Textile Industry. The plan sets guidance targets for the sector with total fiber production at 55 MMT and per capita fiber consumption at 19Kg in 2015 with yearly fiber production growth at 6%. The yarn production target is 34.5 MMT in 2015 from 27.4 MMT in 2010.

#### **Cotton related policy remains unchanged in the foreseeable future**

The cotton textile industry complains that their industry continues to use the most expensive cotton in the world as the government tends to protect domestic farmers income by setting a floor price and controlling cotton imports through a TRQ regime. The cotton textile sector competes with industries in other countries which use cotton resources from the whole world at market prices. Both NDRC and CCA argue that an era of cost driven “high cotton price” has already begun, and the Chinese industry will have to adjust its production strategy to be profitable through technical innovation. The government’s priority is to promote a healthy development of the industry chain. The TRQ regime remains an important policy to maintain domestic cotton production. Given the lower government financial support to cotton farmers (as compared to grain producers), the “purchase cotton for state reserve at floor price” is also a necessary policy. A stable to growing cotton planting area is also in the benefit of the textile industry in meeting cotton demand and stabilizing price.

Other support policies include the continuation of railway transport subsidy to cotton and yarn shipped from Xinjiang, of which the rate increased to RMB500/MT of cotton (from the RMB400/MT in past years). The government also established a reference farm-gate price for seed cotton based on the RMB19,800/MT for grade 328 cotton. Gin/trader seed cotton purchased below the basic farm-gate price should not be sourced as “state reserve”. NDRC added that the government has a comprehensive plan for purchasing the MY11/12 crop for reserve with “unlimited” volume, and arranged appropriate funds and warehousing capacity (currently up to 2 MMT storage capacities).

NDRC emphasized that the relevant government agencies and industry leaders should work closely together to report more reliable data thus facilitating the distribution of additional cotton TRQ (total volume, time, volume/time and pace) for MY11/12.

#### PSD (in 1,000 bales and 1,000 Ha)

Cotton China	2009/2010			2010/2011			2011/2012		
	Market Year Begin: Aug 2009			Market Year Begin: Aug 2010			Market Year Begin: Aug 2011		
	USDA Official	Old Post	New Post	USDA Official	Old Post	New Post	USDA Official	Old Post	New Post
Area Planted	0	5,300	5,300	0	5,140	5,130	0	5,650	5,345
Area Harvested	5,300	5,300	5,300	5,150	5,140	5,130	5,500	5,650	5,345
Beginning Stocks	22,36 6	22,36 6	22,36 6	15,24 6	16,48 4	15,24 6	11,60 3	11,84 5	11,67 3
Production	32,00 0	32,38 1	32,00 0	30,50 0	29,39 5	30,50 0	33,50 0	34,58 5	33,53 0
Imports	10,90 3	10,90 4	10,90 3	11,97 9	15,61 6	11,97 9	14,00 0	16,53 5	13,78 0
MY Imports from U.S.	0	3,399	3,581	0	4,143	5,479	0	4,593	6,800
Total Supply	65,26 9	65,65 1	65,26 9	57,72 5	61,49 5	57,72 5	59,10 3	62,96 5	58,98 3
Exports	23	23	23	122	46	122	50	46	50
Use	50,00 0	49,14 4	50,00 0	46,00 0	49,60 4	45,93 0	45,50 0	50,52 3	45,47 0
Loss	0	0	0	0	0	0	0	0	0
Total Dom. Cons.	50,00	49,14	50,00	46,00	49,60	45,93	45,50	50,52	45,47

	0	4	0	0	4	0	0	3	0
Ending Stocks	15,24 6	16,48 4	15,24 6	11,60 3	11,84 5	11,67 3	13,55 3	12,39 6	13,46 3
Total Distribution	65,26 9	65,65 1	65,26 9	57,72 5	61,49 5	57,72 5	59,10 3	62,96 5	58,98 3
Stock to Use %	30	34	30	25	24	25	30	25	30
Yield	1,315.	1,330.	1,315.	1,289.	1,245.	1,294.	1,326.	1,333.	1,366.