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China - Peoples Republic of

Cotton and Products Update

November Lockup Report

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Report Highlights:

Post's MY14/15 forecast for cotton production remains unchanged from the previous 6.5 million tons. Recently released details suggest that the government's new cotton support policy will lead to a more market-friendly cotton price compared to the artificially-high cotton price resulting from previous floor-setting policies. However, the new policy lowered profit expectations for cotton farmers in the Yellow River and Yangtze River regions and tempered a small expansion in the Xinjiang cotton planted area. Despite a moderate recovery in domestic cotton consumption to 8.35 million tons, the government's decision to restrict cotton import quotas will significantly reduce cotton imports to about 1.52 million tons in MY14/15. As a result, U.S. cotton exports to China will continue to fall in MY14/15.

Executive Summary:

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

Recently released details suggest that the government's new cotton support policy will lead to a more market-friendly cotton price compared to the artificially-high cotton price resulting from previous floor-setting policies. However, the new policy lowered profit expectations for cotton farmers in the Yellow River and Yangtze River regions and tempered a small expansion in the Xinjiang cotton planted area. Despite a moderate recovery in domestic cotton consumption to 8.35 million tons, the government's decision to restrict cotton import quotas will significantly reduce cotton imports to about 1.52 million tons in MY14/15. As a result, U.S. cotton exports to China will continue to fall in MY14/15. China's MY14/15 cotton ending stocks remain high at 12.6 million tons.

Production

China's MY14/15 domestic production will fall to 6.5 million tons based on planted area of 4.41 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 regions. However, major industry sources agree that the cotton planted area in the Xinjiang region remains stable, or may even be slightly up from the previous year. Expectations of higher profits in MY 13/14 and the government's direct subsidy encouraged Xinjiang farmers to keep planting cotton. While this tempered the decline in cotton production in all other provinces, it did not offset the fall in the total cotton production.

In late September 2014, The National Development and Reform Commission (NDRC) estimated MY14/15 cotton production at 6.5 million tons, and indicated cotton consumption will recover moderately to 8.5 million tons due to a more market-oriented domestic cotton price.

Based on a survey conducted in the second half of October, Cncotton.com estimated MY14/15 cotton production at 6.51 million tons, down 4.3 percent over its August estimate. Cncotton.com estimated planted area is unchanged from its August data at 4.22 million hectares while the average yield is down 4.3 percent to 1,543.5 kg/Ha. Xinjiang's production is estimated at 4.2 million tons based on a yield of 1,903.5Kg/Ha and a planted area of 2.21 million hectares.

On October 28, the China Cotton Association (CCA) adjusted its MY14/15 production to 6.66 million tons based on an unchanged planted area of 4.29 million hectares but based on a lower yield due to high moisture during the month of September. As shown in the following table, CCA August report indicated that the Xinjiang planted area is based on the recent official survey which included additional area previously not included in official statistics. In contrast, a 22.7 percent area decline in all other provinces (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.

	National Total		--Xinjiang		--All Other Provinces	
	Area	Production	Area	Production	Area	Production
MY13/14	4,662	7,000	2,126	4,180	2,536	2,820

MY14/15-Aug	4,227	6,730	2,267	4,600	1,960	2,130
MY14/15-Oct survey	4,286	6,660				

Source: China Cotton Association (CCA) Note: in 1000 Ha and 1,000 tons

Direct subsidy details finalized

On September 18, NDRC published policy details of a trial subsidy program in Xinjiang for MY14/15. This trial program will give Xinjiang cotton farmers a direct subsidy if the price falls below a target price of RMB19,800 (\$3,193) per ton, farmers will be compensated based on a combination of their acreage and the volume sold to cotton ginners.

Specifically, based on the difference between the target price and the market price, and the National Statistics Bureau (NSB) estimated Xinjiang cotton production, the central government will estimate the total subsidy amount and then appropriate funds to the Xinjiang government. The Xinjiang government will then distribute the funds in two ways (A) 60 percent of the funds will be based on the certified planted area, and (B) 40 percent of the funds will be based on production. The subsidy is scheduled to be distributed to cotton farmers in February 2015.

Base rates will be calculated as follows:

$$\text{Area based subsidy rate} = \frac{\text{Total funds} \times 60 \text{ percent}}{\text{Certified planted area}}$$

$$\text{Seed cotton production based subsidy rate} = \frac{\text{Total funds} \times 40 \text{ percent} \times \text{lint ratio certified by Xinjiang government for a specific region}}{\text{Certified production}}$$

On November 4, NDRC announced that MY14/15 cotton produced outside of the Xinjiang region (the other nine cotton-producing provinces) will receive a direct subsidy of RMB2,000/ton. The central government will appropriate funds to these nine provinces based on the NSB statistics production data, and provinces have been requested to formulate a subsidy distribution plan for cotton farmers based on their area or production. As for subsidies in MY15/16 and after, NDRC indicated that the subsidy to farmers in the nine provinces will be generally equivalent to 60 percent of the subsidy rate to be distributed to the farmers in Xinjiang in the same year, but the maximum subsidy rate shall not be higher than RMB2,000/ton.

As a result of the government's direct subsidy policy, the MY14/15 domestic cotton price will be lower compared to cotton prices resulting from previous policies establishing an artificially high floor-price. Cotton statistics for Xinjiang are expected to be more reliable as the subsidy will be based on the actual planted area and production. If in the long run, only the cotton that is planted in approved land can be included in the original planting survey and entitled to receive the subsidy, the practice of planting cotton on unreported or unapproved land will likely decline.

In non-Xinjiang cotton provinces, cotton area is expected to fall as the government's subsidy of RMB2,000/ton (maximum level) will render cotton less competitive than other crops such as grain and rice. Given large cotton stocks and slow cotton consumption recovery, the government expects to see a

fall in the cotton area in MY15/16 or in the near future.

Based on an estimated production of 6.5 million tons for MY14/15 (Xinjiang 4.5 million tons and 2 million tons for all others) and an estimated average market price of RMB14,800/ton, the total subsidy is estimated at RMB26.5 billion or approximately \$4.27 billion. (That is, RMB22.5 billion for Xinjiang and RMB4 billion for all other provinces.)

Investment to boost Xinjiang textile

From 2014 to 2018, the central government plans to allocate RMB1 billion per year to develop the textile industry in Xinjiang. According to Xinjiang Daily, in 2014, in addition to the central government's RMB1 billion, the Xinjiang government also added RMB2.5 billion for textile development. In addition, the central government approved a rebate on a value added tax for the Xinjiang textile sector. The Xinjiang government also implemented a variety of support policies such as a transport subsidy for textile and garments, a subsidy for mills using Xinjiang cotton, and an increase in transport subsidy for Xinjiang yarn to be shipped out of Xinjiang. All these policies are aimed at supporting the trial implementation of the current cotton production reform policy in Xinjiang.

Marketing

Cotton harvest is about ten days later than normal due to low April temperatures and strong winds in southern Xinjiang. As of November 19, the China Fiber Inspection Bureau inspected volume was 1.93 million tons, of which 1.67 million tons are from Xinjiang. As of mid-November, the harvesting of Xinjiang cotton was 86.4 percent completed. Overall, the marketing of MY14/15 cotton is going smoothly in Xinjiang given the early announced subsidy based target price and is expected to speed up as the coming cold weather will encourage farmers to sell seed cotton to gins. However, marketing is slow in other provinces as farmers and ginners both are still hesitant to sell/purchase seed cotton as the subsidy details were just announced in early November. Most of the spinning mills take a hand-to-mouth approach in purchasing cotton in order to keep inventory and price risk to a minimum.

In lieu of the marketing efforts for the MY14/15 crop, the release of cotton state reserves stopped in September and it is not scheduled to restart until next March. That said, the release of state reserves could restart earlier depending on changes in market trends and price.

Consumption

MY14/15 cotton consumption is forecast at 8.35 million tons, up from an estimated 8 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. In addition, 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. This will also encourage more domestic cotton consumption.

In MY13/14, China's strong cotton yarn imports, about 2 million tons, reduced the use of domestic

cotton. However, as the price for Chinese domestic cotton lowers closer to that of other world cotton suppliers, cotton yarn imports are expected to level off in MY14/15. Industry insiders believe Chinese spinners can afford to pay RMB2,000/ton more for cotton while staying competitive in the yarn market. China's yarn imports slipped to 453,000 tons in the third quarter of 2014 from the 576,000 tons in the previous year. Smaller imports of yarn will naturally encourage more use of domestic cotton.

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)

As indicated in the table above, the National Statistics Bureau's data shows total yarn production in the first half of 2014 increased by 8.7 percent from the previous year. Industry sources indicate that yarn production for the first three quarters of 2014 stood at 28.4 million tons, up 8 percent over the previous year. China's textile and apparel exports reached \$221.9 billion in the first three quarter of 2014, up 5.95 percent over the previous year. Additionally, Chinese textile and apparel exports are also expected to reach a 7 percent growth rate in 2014. Exports to major markets including USA, EU, Japan and Southeast Asia have seen moderate growth in the first three quarters of 2014.

NDRC also expects that as falling domestic cotton prices will likely fluctuate from RMB14,000 to 15,000/ton, domestic cotton consumption is likely to reach 8.5 million tons in MY14/15 and cotton yarn imports will fall.

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 million tons, a sizeable increase from an estimated 11 million tons in beginning stocks. Post forecasts ending stocks will remain above 12.8 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 will likely remain high at above 150.

MY14/15 cotton imports are expected to fall

MY14/15 cotton imports are forecasted down significantly to 1.52 million tons from the 3.1 million tons in MY13/14 as China is expected to expedite the release of state reserve cotton and bring stocks to a more manageable level in late MY14/15. Anticipating the estimated shrinking supply gap in MY14/15,

and in an effort to boost use of domestic cotton, NDRC will only distribute its WTO import TRQ for 2015 (894,000 tons) and will not issue additional TRQs (subject to a sliding duty). However, in the past, special TRQs have been issued for mills engaged in “processing trade” (for re-export). In the long term, imports 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	4,800	4,700	4,400	4,410
Beginning Stocks	31,081	31,081	50,361	50,271	62,707	59,587
Production	35,000	35,000	32,750	32,150	30,000	29,855
Imports	20,327	20,237	14,122	14,122	7,000	7,000
MY Imports from U.S.	0	5,962	0	0	0	0
Total Supply	86,408	86,318	97,233	96,543	99,707	96,442
Exports	47	47	26	26	50	50
Use	36,000	36,000	34,500	36,930	37,500	38,350
Loss	0	0	0	0	0	0
Total Dom. Cons.	36,000	36,000	34,500	36,930	37,500	38,350
Ending Stocks	50,361	50,271	62,707	59,587	62,157	58,042
Total Distribution	86,408	86,318	97,233	96,543	99,707	96,442
Stock to Use %	140	140	178	176	166	151
Yield	1,438.	1,438.	1,422.	1,422.	1,477.	1,425.
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	5300	5300	4800	4700	4400	4410
Beginning Stocks	6767	6767	10965	10945	13653	12973
Production	7620	7620	7130	7000	6532	6500
Imports	4426	4406	3075	3075	1524	1524
MY Imports from U.S.	0	1298	0	0	0	0
Total Supply	18813	18793	21170	21020	21708	20998
Exports	10	10	6	6	11	11
Use	7838	7838	7511	8040	8165	8350
Loss	0	0	0	0	0	0
Total Dom. Cons.	7838	7838	7511	8040	8165	8350
Ending Stocks	10965	10945	13653	12973	13533	12637
Total Distribution	18813	18793	21170	21020	21708	20998
Stock to Use %	140	139	182	161	166	151
Yield	1,438	1,438	1,486	1,489	1,484	1,474
TS=TD	0	0	0	0	0	0