

USDA Foreign Agricultural Service

GAIN Report

Global Agricultural Information Network

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: 11/30/2012

GAIN Report Number: CH12072

China - Peoples Republic of

Cotton and Products Update

November Lockup Report

Approved By:

Michael Riedel

Prepared By:

M. Melinda Meador and
WU Xinpeng

Report Highlights:

Larger than expected production from Xinjiang raises total production estimate to 6.9 million tons (MT), however, production is still below the 7.2 MT in MY 11/12. Weak global demand, shortage of competitively priced cotton, and increasing fiber substitution amongst domestic mills suggests cotton consumption will remain in decline. Record high government stocks of more than 7 MT and tariff rate (TRQ) controls will negatively impact import levels in MY12/13.

Executive Summary:

Larger than expected production from Xinjiang raises total production estimate to 6.9 million tons (MT), however, production is still below the 7.2 MT in MY 11/12. Weak global demand, shortage of competitively priced cotton, and increasing fiber substitution amongst domestic mills suggests cotton consumption will remain in decline. Record high government stocks of more than 7 MT and tariff rate (TRQ) controls will negatively impact import levels in MY12/13.

Post:

Beijing

MY12/13 domestic cotton production down to 6.9 MT

Post's estimated MY12/13 cotton planted area remains unchanged at 5.05 million hectares (MHa). Post's MY12/13 production estimate of 6.9 MT is up 100,000 tons from the previous report. This increase is due to favorable harvest weather in Xinjiang which strengthened yields and offset some Shandong and Hebei losses following typhoon rains this summer. MY12/13 production expectations, however, remain below MY11/12's total production of 7.2 MT.

In September, China Cotton Association (CCA) forecast MY12/13 total production at 6.95 MT, down 4.4 percent over the previous year, due to Shandong and Hebei losses. In October, China's National Cotton Exchange Market estimated MY12/13 cotton production at 6.94 MT and China's National Development and Reform Commission estimated a figure of 6.9 MT, based on cross-agency data.

Regarding Xinjiang in particular, MY12/13 cotton production is estimated at 3.7 MT, according to industry sources. In November, the Xinjiang Daily estimated MY12/13 cotton production at 3.18 MT, up 9.7 percent over the previous year. Other regional news sources reported record cotton production, such as Bazhou (380,000 tons) and Akesu (573,730 tons). On November 16, Xinjiang Production and Construction Corporation (PCC) set its MY12/13 PCC cotton production at 1.38 MT, based on an average yield of 2,490 Kg/Ha on planted area of 8.3 MMu (or 553,300 Ha).

All cotton producers continue to face increasing production costs. In late October, China Cotton Research Institute estimated that MY11/12 cotton production costs averaged RMB22,545/Ha (\$3,578/Ha), up 21 percent over the previous year, with labor costs accounting for more the half of the increase. MY12/13 production costs are expected to continue to rise as well.

State purchase of MY12/13 cotton drives state reserve to record high

The MY12/13 cotton harvest is almost complete and sales are well underway. Government purchases of domestic cotton at a minimum price of RMB20,400/ton (\$3,238/ton), according to China National Cotton Reserve Corporation, has reached 3.27 MT as of November 26, compared to the total 3.25 MT

purchased in MY11/12. This quantity represents 89 percent of the total 3.96 MT of classified cotton according to China Fiber Inspection Bureau, eclipsing the 842,000 tons of classified cotton purchased in the same period in last year. Only classified cotton can be purchased as state reserve, so cotton subject to classification is increasing to access the government premium (higher than market) price.

Within the 3.27 MT reserves purchased as of November 26, 67 percent (2.18 MT) is believed to be Xinjiang-origin cotton. A Xinjiang PCC official stated they expect to sell 1.1 MT-1.3 MT to state reserve out of 1.38 MT total production.

With the inclusion of the latest purchases, total state cotton reserves estimated at 7.2 MT would be a historic level. Total reserves could climb higher though as the government purchase program continues through March, 2013.

State Reserve Release

In September, 2012 China offered 1 MT of cotton at auction at RMB18,500/ton (\$2,940/ton), a price seven percent below the floor price at which the government purchased it in MY11/12. Industry sources indicate that spinners/mills only purchased approximately 500,000 tons of cotton, suggesting the cotton purchase price was too high for the mills to make a profit when facing soft world demand, and the mills remained reluctant to enter the market to add supplies at such a high price.

MY12/13 cotton consumption expected to be bearish

For MY11/12, estimated cotton consumption was 8.5MT, consisting of 4 MT from domestic production (7.2 MT total production less 3.25 purchased for state reserve) and 3.54 MT of imported cotton (total imports less 900,000 tons at bonded warehouse and 900,000 tons imported for state reserve). The 1 MT gap can be attributable to industry inventory.

Continued weak demand for textile products in MY12/13, however, will drop consumption estimates to 8.3 MT from the previous year's 8.5 MT. The textile sector operation rate continues to decline in response to supply/demand challenges, both in terms of firm closures and operation curtailment. Currently the gap domestic cotton prices versus imported prices, ranging from RMB3,500 (\$560/ton, for 1 percent import duty) to RMB4,500/ton (\$720/ton, for sliding duty) far exceeds the normal price difference of about RMB1,000/ton which spinners can afford to absorb. As a result, spinners have used their own stocks and then increasingly sought additional fiber resources, including not only imported cotton, but imported yarn and manmade fibers to keep the operations going, which has further depressed domestic cotton consumption.

Imported Cotton:

MY 12/13 China's cotton imports are forecast at about 2.4 MT. The central government's record state cotton reserve levels and tight control of the TRQ import distribution restrains cotton import forecasts for MY12/13. On the far side of pessimism, rumors are that the TRQ with sliding duty might be suspended, and that only the WTO committed 894,000 tons, plus an appropriate TRQ quantity for "processing trade," might be distributed in 2013 (see Policy Section).

Estimated Cotton Import TRQ Distribution (tons) from 2011 to 2013

	WTO Committed (1% duty)	TRQ subject to sliding duty		Total
2011	894,000	2,700,000		3,594,000
2012	894,000	1,500,000*	400,000*	2,800,000
2012	894,000	1,600,000**		2,500,000**

*estimates by industry sources; the estimated 900,000 MT of imports for state reserve by China State Cotton Reserve Corp is not included as it might be specially approved by the government.

**estimated by industry sources.

The recovery of world demand for textile and apparel products is another important factor influencing China's cotton imports.

China's Cotton Imports (MY08/09-MY12/13; ton)

MY(Aug-Jul)	MY08/09	MY09/10	MY10/11	MY11/12	MY12/13 (est)
World	1,523,643	2,374,234	2,609,365	5,341,730	2,400,000
India	152,687	780,140	631,410	1,941,721	
United States	908,416	779,751	1,193,644	1,309,526	

Source: Global Trade Atlas; MY12/13 estimate by Post

Imported Yarn:

Yarn imports exceeded 1 MT in the first nine months of 2012, almost double the volume from last year, with net imports up 450,000 tons over the previous year.

China's Yarn Trade Trend (Jan to Sep 2008-2012; MT)					
	2008	2009	2010	2011	2012
Imports	570,161	681,678	756,022	550,937	1,005,286
Exports	393,620	350,637	348,332	235,339	238,606
Net Imports	176,541	331,041	407,690	315,598	766,680
Change %		+87	+23	-22	+143

Source: Global Trade Atlas

Exports

Total textile and apparel exports of \$137.4 billion in the first seven months of 2012, down 0.2 percent over last year, support a smaller export volume as unit price has increased in general.

The following table shows China's textile and apparel exports, by value and by destination, in the first three quarters of 2012. Total growth of 0.5 percent is expected, with rapid increase to ASEAN countries which benefit from a regional trade agreement, but significant contraction to Europe and slow growth to the United States and Japan, reflecting their sluggish economic conditions.

Furthermore, compared to last year, China customs data shows apparel export volume declined 1.8 percent in the first eight months of 2012. Perhaps reflecting this trend, a recent Guangzhou Export Fair posted a 15.5 percent decline, by value, in textile and apparel exports, compared to the same Fair in May 2012.

Country or Region	Export Value	Change % over 2011 (Jan to Sep)
Total	187,156.8	0.5
Asia	81,017.4	4.1
--ASEAN	17,291.4	20.8
---Japan	20,164.9	1.4
---Middle East	14,812.4	19.6
Africa	11,485.5	14.5
Europe	44,852.3	-10.5
--EU-27	36,171.2	-13.5
USA	29,463.7	3.4

Source: Cncotton.com

Yarn Production: The textile sector output value in the first ten months of 2012 is up 12.5 percent over the previous year, according to National Statistics Bureau (NSB). The official data supports a strong growth of yarn production, up 13.9 percent in the first ten months of 2012, though many industry insiders question this statistics could be overly robust.

Month	Yarn Production			Chemical Fiber Production		
	2011	2012	Change%	2011	2012	Change%
Oct	2,639	3,034	14.97	2,949	3,286	11.43
Sep	2,629	2,982	13.43	2,995	3,298	10.12
Aug	2,441	2,782	13.97	2,935	3,334	13.59
Jul	2,446	2,729	11.57	2,809	3,160	12.5
Jun	2,606	2,833	8.71	2,964	3,338	12.62
May	2,408	2,669	10.84	2,873	3,543	23.32
Apr	2,303	2,635	14.42	2,654	3,163	19.18
Mar	2,310	2,788	20.28	2,815	3,167	12.5
Feb	1,889	2,369	25.41	2,285	2,995	31.07
Jan	2,050	2,074	1.17	2,581	2,727	5.66
Total	23,721	26,895	+13.4	29,871	34,023	+13.9

Source: Cncotton.com/NSB

Cotton policy dilemma

The current situation of record government stocks and shortage of competitively priced cotton is strangling the textile sector. This prospect has triggered significant controversy regarding the

government's cotton regulatory policy. The policy makers face unprecedented challenges in balancing a protected cotton sector and a viable textile sector in MY12/13 and beyond.

1-Domestic cotton production policy unlikely to change

China's Ministry of Agriculture (MOA) has set an annual production target from 2011-2015 at 7 MT on planted area of approximately 80 MMu (5,333,000 Ha). However, to meet this goal, farmers face rising input costs and cotton's labor intensive demands, making it one of the most difficult and least profitable crops in China. To offset plunging competitiveness with other crops and influence farmers toward cotton production, the government provides income subsidies in the form of a minimum purchase price for classified, quality cotton and controls imports. In recent years, this domestic floor price has exceeded world price which has enticed the majority of the domestic cotton crop to flow into government inventory. As a result, domestic mills have consumed their inventory and faced higher prices for additional raw materials. In addition, China controls the mills' access to lower-priced world cotton imports through a tariff rate quota which further restricts supply and raises prices for the textile industry. With the world economic slowdown and lower demand, retail prices do not support the absorption of ever increasing costs by the China textile industry. It appears the Chinese policy makers are willing to accept textile industry consolidation, as smaller operations crumble under the financial squeeze, as a result of their cotton subsidy policy.

Although this policy will continue next year, with perhaps an even higher floor price, there are some interesting theories circulating about alternative ideas for the future. One idea is that as China's demand for other bulk agricultural commodities continues to surpass domestic production capacity, in the long term, the government might forego its support of cotton farmers to the benefit of another major crop, say corn. Or perhaps it would maintain a production subsidy for the most important production region, Xinjiang, as a basis of maintaining social and production stability, but release the subsidy in areas more fertile for alternative crop production, such as the Yangtze River and Yellow River regions.

In any event, Xinjiang cotton production will remain protected. In November, Xinjiang Daily reported the government will invest RMB1.4 billion in the next three years to build cotton producing base in Xinjiang. The funds will mostly be used in improvement of cotton land, new cotton varieties, seed processing facilities, irrigation system, precise farming and harvest mechanization (with target of adding new mechanized harvesting area of 61,500 Ha). The PCC plans to invest more on cotton land so as to maintain yearly cotton production at 1.3 MT based on planted area at 7.5 MMu (or 500,000 Ha) with yield up to 2,595Kg/Ha by 2015. The PCC mechanized harvest area reached 5 MMu (333,000 Ha) and target mechanized harvested area will be 6 MMu (400,000 Ha) by 2015.

2- The textile sector challenges

The textile sector faces a serious shortage of competitively priced cotton as a result of the government's minimum purchase price and its control of import TRQ. Outside of China, world cotton inventories are swelling as China's cotton stockpiles reduce the need for imports and world cotton prices fall in response.

Despite the lack of an import quota, traders continued to send cotton stocks to China's bonded warehouses. This inventory, which peaked at an estimated 900,000 MT in June and July 2012, waited for world prices to fall to a point where the payment of a 40 percent out of quota tariff still presented a viable price for Chinese mills desperate for raw material. By November, most of these bonded stocks had cleared customs.

China's industry leaders, aware of the tight cotton supply, are rumored to be considering an auction of state reserves in December. However, the selling price will be an issue. At the last auction in May, only 50 percent of the cotton offered was purchased by mills, perhaps signaling mills refusal to pay this price, despite the need for raw materials. Regarding TRQ distribution, if cotton consumption demand does not show a significant recovery, then MY12/13 TRQ distribution will remain tight and imports will fall. Some options under consideration include TRQ distribution subject to an equivalent purchase quantity of state reserve and suspension of the TRQ subject to sliding duty.

PSD Table (1,000 Ha and 1,000 bales)

Cotton China	2010/2011		2011/2012		2012/2013	
	Market Year Begin: Aug 2010		Market Year Begin: Aug 2011		Market Year Begin: Aug 2012	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Area Planted	0		0		0	
Area Harvested	5,250	5,138	5,400	5,380	5,000	5,050
Beginning Stocks	14,246	14,246	10,603	10,674	30,181	29,222
Production	30,500	30,500	33,100	33,070	31,500	31,700
Imports	11,979	11,982	24,533	24,533	11,000	11,000
MY Imports from U.S.						
Total Supply	56,725	56,728	68,236	68,277	72,681	71,922
Exports	122	122	55	55	75	75
Use	46,000	45,932	38,000	39,000	35,500	38,100
Loss	0		0	0	0	0
Total Dom. Cons.	46,000	45,932	38,000	39,000	35,500	38,100
Ending Stocks	10,603	10,674	30,181	29,222	37,106	33,747
Total Distribution	56,725	56,728	68,236	68,277	72,681	71,922
Stock to Use %	23	23	79	75	104	88
Yield	1,265.	1,292.	1,335.	1,338.	1,372.	1,367.

