

Cotton Outlook

Special Feature

June 2019



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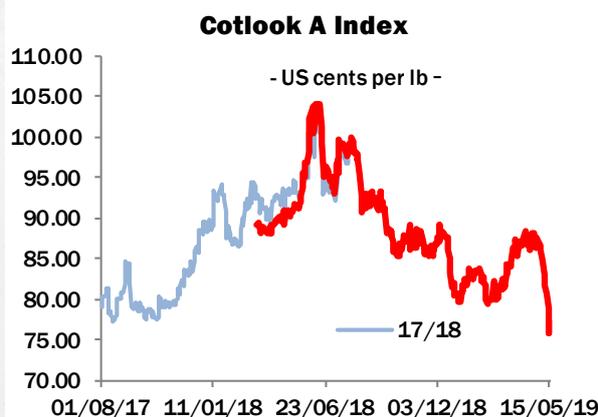
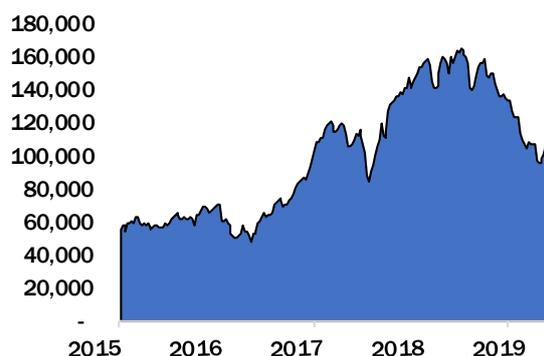
Twelve Eventful Months in the International Cotton Market



Mike Edwards, Editor, Cotton Outlook

When delegates from China and overseas travelled to the China Cotton Industry Development Summit in Harbin in early June 2018, international cotton prices were conspicuously firm, supported by the conjunction of several bullish factors. The Cotlook A Index – the barometer of the world market – stood at over one dollar per lb, a threshold crossed on only a handful of occasions during the 50-plus years during which the Index has been in existence. New York and Zhengzhou futures were taking turns to lend new bullish impetus to the market. Reports of adverse weather in Xinjiang (since largely discredited) prompted a strong wave of buying in the Zhengzhou No. 1 cotton contract. Unfixed on-call sales in New York meanwhile stood at over around 160,000 contracts (equivalent to sixteen million bales or about 3.6 million tonnes), just below the record attained in mid-May.

Unfixed on-call sales (contracts)



However, June was to prove the high watermark of world prices at least for the recent past as external developments began to undermine trading confidence on both the local and international markets. Trade tensions between the United States and various trading partners including China had been worsening for some months, and in early July cotton became embroiled in the dispute when Beijing introduced an additional 25-percent tariff on imports of US cotton. Fears (partially realised) of an escalation of the 'tariff war' and the attendant loss of confidence in the economic outlook were to characterise the next few months.

The same period saw sometimes acute financial difficulties surface on a number of 'emerging' markets, of which the most noteworthy was no doubt Turkey, the world's sixth largest consumer of raw cotton and a major export market for the United States crop.

By early June, the 2018 State Reserve auction series was about to enter its fourth month, with an aggregate quantity well in excess of one million tonnes disposed of since the start of a process that would eventually see government stocks reduced by over 2.5 million tonnes. From the perspective of the international trade, the point at which the State Reserve would be reduced to manageable proportions, and China's structural deficit would require imports on a more substantial scale, no longer seemed a distant prospect.

Export statistics for the 2018/19 marketing year tell the story. By late April 2019, US upland sales to China were 33 percent below those a year earlier, while those to Turkey were nearly 30 percent lower. Of the major markets, only Vietnam had purchased more US cotton than in the previous season.

The strong rise of prices (in which speculation was acknowledged to play a major part) prompted the Chinese government to issue a discretionary raw cotton import quota in the amount of 800,000 tonnes, the first such release since 2014, with the intention of bringing some calm to Zhengzhou and to the domestic market in physical cotton.

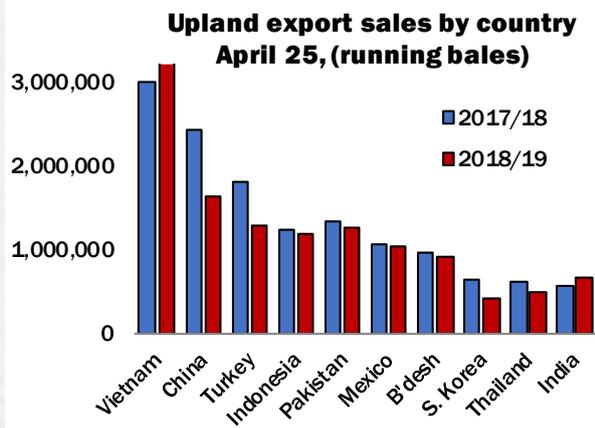
The bearish impact of these shortfalls might have been greater, had the size of the US crop lived up to early expectations. Cotton was planted on 14.1 million acres (5.7 million hectares), the largest area since 2011. However, a series of adverse weather developments occurred during the growing season. These included arid conditions in West Texas that caused over 40 percent of the major growing region's crop to be abandoned in the field. Successive hurricanes took a toll on cotton in the Southeast. Finally, the harvest period was dogged by unwelcome wet weather across many parts of the cotton belt, causing a loss of yield and a noteworthy reduction in the average grade produced.

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Tel : 44 (151) 644 6400 Fax : 44 (151) 644 8550 E-Mail : editor@cotlook.com World Wide Web : www.cotlook.com

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Since the turn of the year, a partial recovery of international prices has been observed. By late April, the Cotlook A Index was once again in the high 80s cents per lb, having gained nearly nine percent in value during the first four months of 2019. The market's more positive direction can be ascribed to a number of factors. The December 'truce' in the Sino-US tariff war and the progress apparent in subsequent negotiations was certainly one. Some of the embattled 'emerging' markets alluded to have regained a degree of stability. Overall, buying confidence on the part of spinners appears to have returned, though many continue to complain that the margins obtainable from sales of cotton yarn remain far from satisfactory. Import demand for raw cotton from China has also been supportive. Arrivals were heavy during January and February and the total for the August/March period, at over 1.4 million tonnes, suggests that Cotton Outlook's forecast for the international cotton season, two million tonnes, is within reach. That would represent the highest volume imported since the 2013/14 season.

The upward trajectory of world prices was brutally reversed in early May, however, as it became apparent that a Sino-US accord was not, after all, imminent. Instead, a new escalation of the conflict saw cotton futures in both New York and Zhengzhou fall sharply, amid renewed apprehension with regard to the disruption of trade flows and a weakening of economic growth. By the middle of the month, the 2018/19 Cotlook A Index had fallen decisively below the benchmark of 80.00 cents per lb, to touch its lowest point since its introduction in March 2018.

Even before the dramatic fall of prices during the first half of May, a number of factors militated against a decisive shift of market sentiment to the bull side. Although China's structural deficit should at some point become a major influence on the international market, traders are not unaware that the country's 'commercial' stocks (those held outside the State Reserve) are unusually high. Moreover, the outlook for supply and demand during the 2019/20 season is gradually becoming more clearly defined. Planting in the Northern Hemisphere is under way amid expectations that cotton area will be maintained or increased in several major producing and exporting countries.

Cotton Outlook's forecasts for the season ahead place world production at just over twenty-seven million tonnes, a threshold crossed only once before, in the 2011/12 season. On the demand side of the equation, global consumption is predicted to surpass 26.6 million tonnes for the first time. Both production and consumption may therefore be testing new boundaries during the 2019/20 campaign and in subsequent seasons.

That being the case, the capacity of various countries to increase cotton production has increasingly come under scrutiny. In this regard, the greatest potential would seem to exist in Brazil's center-west. Although cotton in that region is not irrigated,

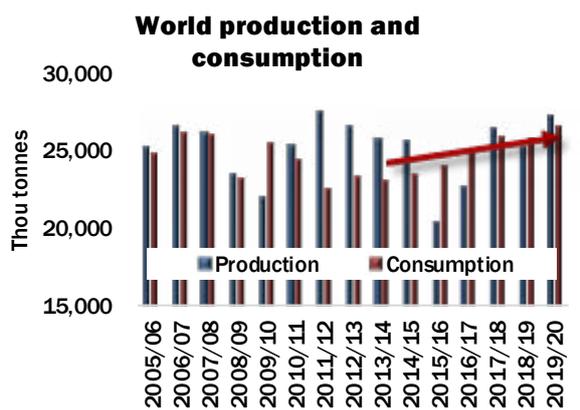
the pattern of rainfall is very predictable in most seasons. In the largest producing state, Mato Grosso, most of the cotton crop is sown directly after the soybean harvest, offering farmers revenue from two crops rather than one. Elevated costs of production have been offset by improvements in yield in recent seasons and in 2019 it is anticipated that Brazilian production will rise by approximately one third to approach 2.65 million tonnes of lint. Logistics remain the principal brake on growth and it remains to be seen how smoothly the interior transport and shipment of the bumper 2019 crop will prove to be. On the marketing front, for buyers in China Brazilian has proved a popular alternative to US cotton during the period in which tariffs have rendered the cost of the latter origin prohibitive.

At 4,733,000 tonnes (21.74 million bales of 480 lbs), our forecast of US production, if realised, would be the biggest crop since the 2005/06 season and the third largest in history. Moreover, if the recent favourable pattern of rainfall in West Texas is sustained, that figure may err on the side of caution, since it assumes average abandonment.

Hopes of a recovery in output in India rest largely on the better distribution of Monsoon rains in the major producing states, but also on the provision of good quality planting seed and the effective control of insects. These last two considerations are likely to be prominent also in Pakistan, where there appears considerable enthusiasm amongst cotton farmers, who are likely to increase plantings at the expense of sugar.

At just over 500,000 tonnes, output from Australia's 2018/19 crop promises to be less than half of the country's record production, not because cotton is unremunerative but simply because water is in short supply. Unless the prevailing drought is broken, the next crop will be smaller still.

The world clearly has the capacity to produce more cotton than it does at present and current world prices would seem to provide a sufficient incentive to do so. However, the tension between supply and demand could become more acute over the next few seasons and prices are therefore potentially more sensitive to any weather-related setback. The Intergovernmental Panel on Climate Change has predicted a loss of agricultural productivity, which could affect cotton, over half of which is cultivated under non-irrigated conditions, no less than other crops.





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Over Supply Suppresses Prices, Supportive Factors Awaited

Honghonghua, Changjiang Futures

Supply and Demand Analysis

Domestic market 2018/19

The supply and demand situation this year appears relatively clear. We place production in Xinjiang at 5.13 million tonnes, and 500,000 for the 'mainland', while consumption is 8.5 million, so the supply gap will be 2.87 million tonnes. However, if we consider the additional Sliding-Scale quota of 800,000 tonnes, imports of two million tonnes, and the volume planned to be offered at State Reserve auctions (one million tonnes), we can see a surplus of 130,000 tonnes. Beginning stocks in 2018/19 were 2.7 million tonnes; a total of 400,000 tonnes were sold from the reserve during the extended auction series last year, and 800,000 tonnes of Sliding-Scale quota was allocated, while only half of said quota was consumed. As a result, ending stocks in 2018/19 will be 3.33 million tonnes, reflecting a relatively abundant supply situation in the current and forward seasons (a negative factor for prices in the short to medium-term).

Domestic market forecast in 2019/20

Area in Xinjiang might fall slightly from last year, due to low temperatures, precipitation and hailstorms, which are not helpful to final yields, so weather conditions will be crucial. We place production in the next season at 5/5.2 million tonnes in Xinjiang, and 500,000 in the 'mainland', so the national total is 5.5/5.7 million. Consumption is estimated at 8.3 million, so the supply gap will be 2.7 million. If imports reach three million tonnes and State Reserve sales achieve 500,000, domestic supply will be sufficient, but one thing that is certain is that state stocks are declining (a positive factor for price direction).

World supply and demand 2018/19 (with reference to April 2019 USDA report)

World production in 2018/19 is estimated at 25,894,000 tonnes, down 3.9 percent from the previous season (26,946,000), or minus 1,052,000 tonnes. Chinese production stands at 5,630,000 tonnes, up 100,000, year-on-year. The figure for the US is 4,004,000 (down 551,000), while Indian output is 5,879,000, down by 435,000. World consumption in 2018/19 is placed at 26,820,000 tonnes, up 92,000 from the previous season (26,728,000). It may be recalled that USDA said in its June 2018 forecast that global consumption would increase by one million tonnes, but that figure had been reduced to 500,000 by October 2018. USDA continued to gradually lower their consumption number, until finally all of the one million tonne increase disappeared. From a global perspective, the world supply gap in 2018/19 is 926,000 tonnes. In 2017/18 there was a surplus of 218,000 tonnes, and China sold 2.5 million tonnes of state stocks, so the volume added to global stocks in trade hands was 2,718,000 tonnes. In 2018/19, global supply is expected to have increased by 2,792,000 tonnes, which is clearly a negative factor for prices.

World 2019/20 outlook

Planted area in the United States is expected to increase slightly next season. Last year, affected by drought, the rate of abandonment increased and yields decreased, so US output has declined by 551,000 tonnes in 2018/19. If weather conditions revert to a more usual state, US production could increase by 800,000 tonnes in 2019/20. Indian output has also decreased this year, due to late Monsoon rains in August and September 2018. However, if the weather system advances as normal this year, output in India will increase by 500,000/800,000 tonnes. Hence, it is possible that global output in 2019/2020 will increase by 1.3/1.6 million tonnes. If consumption declines slightly as is expected, the global surplus will be 374,000-674,000 tonnes. When added to the already existing stocks of 2,792,000 in 2018/19, the global surplus will be 3,166,000-3,466,000 tonnes. However, if the weather is bad this year in the US and India, then there might be further reductions to the production figures and output will be roughly the same as last year. Should trade frictions between China and the US come to an end, and consumption begin to recover, cotton prices could rise strongly. (Most of the factors for next year are variable, like weather, consumption, trade disputes, the economic situation and State Reserve sales.)

Balance Sheet

Domestic balance sheet

We can see from the balance sheet that the industrial and commercial stocks during the fourth quarter of 2018 were ample, at 3.6 million tonnes, mainly owing to the extension of last year's State Reserve sale, as well as the release of an additional 800,000 tonnes of quota (though

China Balance Sheet

	15/16	16/17	17/18	18/19	19/20
Production	450	460	550	563	580
Consumption	750	810	870	850	830
Supply Gap	-300	-350	-320	-287	-280
Imports	96	100	120	160	200
Sold from Reserve	262	322	250	100	50
Annual Supply Gap	-4	10	0	-47	0
Ending Stocks	180	250	312	355	375
4Th Quarter Industrial/Commercial Stocks	242	312	402	435	375
Note	4th quarter stocks=ending stocks+reserve crops sold during extended month+actual transaction of additional quotas (excluding 894,000)				

only half of that was used). In September, when the bulk of new crop cotton has arrived, we can say the worst period of oversupply has passed. In 2018/19, domestic supply was abundant. Given the high level of industrial/commercial stocks, even if the trade war continues and no imports are allowed, the supply will still be sufficient. If all goes well, ending stocks in 2018/19 will reach 3,330,000 tonnes. If weather is not a problem, supply will also be maintained for next season; if not, the only resources we can depend on are State Reserve stocks, however, as all know, those stocks have been falling so the supply would be tight for next season.

World Balance Sheet

	15/16	16/17	17/18	18/19	19/20
Production	2093.6	2322.3	2694.6	2589.4	2734.4
Consumption	2465.5	2529.6	2672.8	2682	2600
Supply Gap	-371.9	-207.3	21.8	-92.6	134.4
Ending Stocks	1966.8	1750.5	1764.6	1664.4	1709.4
Reserve Crops Sold	262	322	250	100	50
Stocks Hangover	-109.9	114.7	271.8	7.4	184.4

Global balance sheet

From the global supply and demand table, it can be seen that the biggest supply gap happened in 2015/16, and then 2016/17, and became smaller in 2017/18. With the continued implementation of State Reserve sales, inventories globally have been expanding and raw cotton resources are very abundant. The high level of output seen in recent years, added to the stocks accumulated in warehouses, are enough to satisfy consumption, while the state sales in China, trade tensions and economic downward pressure, all resulted in lower than expected global consumption in 2018/19. If area is maintained in China, with good weather conditions and high yields, the pressure from oversupply will be considerable.

Policy will remain influential to cotton

1. The policy of state buying and selling in the next year or so will be decisive to cotton prices; the volume sold at auction in 2019 could be 500,000 to one million tonnes, as could the volume bought by the government. Xinjiang and US cotton in particular might be targeted, given the increase of stocks in those countries.

2. In the future, China's dependence on additional quota will be greatly increased, and the timing and quantity of quotas will remain influential, causing greater sensitivity to imported cotton prices.
3. This year will be the last year of the direct target price subsidy policy; how will the policy be implemented next year, and how will this affect area and output?
4. Area next year will be influenced by cotton prices and growers' incomes this year.

Macro factors will play an important role in cotton prices

1. Trade frictions between China and the US have become a major factor for cotton prices. Consumption has been lowered by one million tonnes, which in return will affect the economy and hence consumption.
2. Evolution of the trade war: following a whole year of negotiation, both sides have got a clear picture of the other's perspective and aims. An agreement and is not likely in the short term. Despite the



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e-mail: info@wiscontrol.com

Wakefield Inspection Services Inc
1517 G Avenue, Plano TX 75074 USA
Tel: +1 972 690 9015
Fax: +1 972 690 7042
Skype: wiscotton
e-mail: info@wiscontrol.com

Wakefield Inspection Services (Asia) Ltd
Xin Dong Fang International Business Center, 502
525 Zhen Ning Road, Shanghai 200050 China.
Tel/Fax: + 86 21 3214 1236
e-mail: chn-info@wiscontrol.com
e-mail: info@wiscontrol.com



cease fire established earlier this season, President Trump reignited the dispute in May, increasing tariffs from ten to 25 percent on Chinese goods to the value of US\$200 billion. Additional tariffs also affect consumption.

3. Domestic macro policies: during periods of downward pressure on the economy, the Chinese government implemented tax reductions and eased monetary policies, so as to stimulate the real economy, with some positive results.
4. The Federal Reserve's monetary policy has also been changed to a less aggressive stance; interest rate rises have been suspended and global monetary policy has been eased lately.

Impact of large certificated stocks on prices

1. The level of certificated stocks plays a role in influencing price movements on the futures market, especially when prices are rising. When prices are in decline, certificated stocks tend to increase.
2. Certificated stocks should decrease from their current level. Although global supply is abundant, domestic supply is even more so and the cotton available will finally be consumed when prices are considered attractive.
3. A large proportion of the certificated stocks should be consumed via the January '20 contract, which will bear considerable price pressure.

Summary

Global planted area and production have been increasing in recent years. Given the availability of a huge volume of stocks resulting from state sales and additional import quota, as well as the negative consumption outlook, it will be very hard for prices to rise. For 2019/20, the positive factors include low national stocks, macro-economic stimulation, and the likelihood of an El Nino year, while negatives include the potential rise in output, lower consumption owing to the further escalation of trade frictions, resultant oversupply and so on. In summary, we believe prices will remain weak this year, and fluctuate next year under the influence of several negative factors, including bad weather, a macro-economic downturn and another State Reserve series. Cotton prices will run between 13,000 and 15,500 yuan per tonne this year, and 13,000 and 18,000 for next year.

We advise enterprises to be fully prepared for the trade war to avoid risks. In addition, they also need to focus on hedging in view of the global rise in output next year, which will place pressure on forward contracts. In the event that no financial crisis occurs, global cotton prices will be mostly supported by planting costs, which currently stand at 55 cents per lb for US crops, while 60 cents would be more supportive.



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The logo features a stylized blue outline of a cotton plant with leaves and a cotton boll. To the right of the plant, the name "Jess Smith" is written in a large, flowing, blue cursive script. Below this, "& SONS COTTON, LLC" is written in a smaller, blue, sans-serif font.

Jess Smith & Sons Cotton, LLC
2905 F Street
Bakersfield, CA 93301

Tel: (661) 325-7231

www.jesssmith.com
traders@jesssmith.com



The Future Development of China's Cotton Industry

China Cotton Association

China's cotton textile industry has been developing rapidly since the policy of reform and opening up was introduced. Production of cotton products now basically meets domestic demand, while cotton textiles and apparel are exported around the world as China has become a true cotton and textile industrial power. With the development of economic globalization, a new round of technological revolution and industrial transformation led by information network technology is emerging. The founder of the World Economic Forum, Klaus Schwab, called it the 'Fourth Industrial Revolution'. The main features are digitalization, information networks, intelligence and green issues. It will drive the deep integration of information network technology and manufacturing, as well as reshaping the global industrial pattern, particularly in terms of division of labor. In order to meet the challenge of the new industrial revolution, in recent years, many countries have introduced medium to long-term development strategies in their manufacturing industries, such as Germany's 'Industry 4.0', China's 'Made in China 2025', UK's 'Industry 2025 strategy' and Japan's 'New Robot strategy'.

The impact of the fourth industrial revolution is comprehensive, and both traditional and emerging industries face opportunities and challenges. New opportunities brought about by the Internet of Things, big data, and cloud computing, new technologies, new formats, and new models will reshape the future development of China's cotton industry.

In terms of production, China's cotton cultivation will continue to be dominated by small-scale farming, which is characterized by a lack of centralization and poor risk resistance. However, the new industrial revolution brings the

advantages of networking, and platforms which reduce the barriers to entry. The popularization of the internet provides more equal opportunities; smartphone apps provide an open platform for making more possibilities a reality. Now, farmers can purchase agricultural materials, insurance, join cooperatives and learn about market information via those apps, and in the future will be able to purchase futures and options to conduct hedging by more convenient means. This allows participants to better enjoy agricultural and social organization, to carry out bespoke production practises and so on. The development of 'big data' technology makes it possible to collect, integrate and share information regarding cotton production, procurement, ginning, inspection and trading, which is not only convenient to understand cotton quality traceability, but also to allow a greater number of farmers to attain 'information equality'.

In terms of circulation, China's cotton ginning and distribution enterprises are generally 'small and scattered', with only a few leading companies having strong market influence. Excessive competition is common, and the development of industrialized operations is lagging. The advancement of network technology and the sharing economy brought about by the fourth industrial revolution should enable a company to create and share with numerous customer groups via a single network. Progress in the field of transportation and information technology, and the development of the 'Internet of Things', have also reduced the costs associated with intermediary services. Some enterprises have established regional cotton exchange markets, cotton associations, integrated online and offline operations, solved financing bottlenecks, reduced trading costs and formed a community of common interests with farmers by establishing an e-commerce platform. Under





the 'sharing economy' model, larger enterprises can build up said platforms and attract small to medium-sized enterprises to use those platforms for sharing information and logistics, to integrate industries and reduce transaction costs of the industry chain.

With the development of economic globalization, resource allocation has become a way for enterprises to enhance their competitive advantages. Through global distribution, they can make better use of advanced technologies, management experiences and preferential policies. China's cotton textile enterprises need not only to increase their overseas operations, but also to optimize and reorganize their value chain and production process, to fulfill the multi-regional coordination of research and development, and to realize globalization of resource allocation.

Against the backdrop of this new industrial revolution, manufacturing and service industries are also deeply integrating, and consumer trends are changing. For example, in the US, commodity consumption has been declining but the consumption of services has been rising in recent years. Previously, the main target of domestic enterprises was 'selling products', but now it has become a combination of 'products + services'. The establishment of premium brands that provide high-quality cotton and services is also an inevitable requirement for increasing global consumption. The China Cotton Association has been committed to promoting the brand of 'Cotton China' of late, which denotes high-quality domestic cotton at a reasonable price. So far, a total of 26 enterprises have been approved to use the logo. CCA will check the quality of those products at any time to ensure that they meet the specific quality requirements and maintain the logo's credibility.

In terms of textiles, since the beginning of China's reform and opening up 40 years ago, the nation has gradually narrowed the gap with developed countries by virtue of population, policy dividends and rapid technological imitation, and has become the world's largest textile producer and exporter. With the new industrial revolution leading to changes in the field of intelligent manufacturing,

the upgrading and transformation of China's textile and garment industry has developed rapidly. It is understood that the current rate of automation in China's apparel production has reached 80%, and the equipment, production lines and workshops are intelligent. As well as cloud manufacturing, collaborative manufacturing and customization will be implemented step by step. At the same time, the substitution of machines for manual workers has been increasing, and China's advantages regarding labour costs compared with developed countries is decreasing. In addition, some countries in South-east Asia, Africa and Latin America have been attracting textile industry investment via lower labour, electricity and tax costs, so China is now facing increasingly fierce international competition. Chinese companies will be required to continuously introduce new products, adopt new technologies, and conduct in-depth research on industry development rules and future consumption trends, to promote the transformation of China's textile industry from capital-intensive to knowledge and technology-intensive.





A Tiny Rowboat--China's Cotton Textile Industry

Wang Jun, Hantrong Investment Co., Ltd

Looking back over the past year, cotton markets at home and abroad have both entered another new chapter. In Xinjiang on May 16, prices of cotton and cotton yarn futures on the Zhengzhou Commodity Exchange surged, and with participants anticipating a bullish market run most of them were active in placing orders and procurements. However, the rally was short-lived; with the escalation of Sino-US trade frictions and the commencement of the State Reserve auction, the exchange rate collapsed, orders were sluggish and consumption plummeted; beautiful dreams vanished like soap bubbles. Imported cotton and cotton yarn had accumulated at all domestic ports owing to slow sales, not least from US importers, who were facing a high tariff of 25 percent. Most enterprises understandably could not bear such great pressure. As a result, those traders have suffered from widespread losses and are contending with the risk of defaults, delayed shipments and additional margin requirements.

The progress of the market in 2018 deserves deep introspection. Against the backdrop of tremendous macroeconomic changes, the cotton textile industry is clearly inappreciable, but all participants in this sector have had to face said changes. The traditional methods in the industry are far from being able to cope with such upheaval, so participants need to strengthen their 'pluralistic knowledge' to better understand changes in the market, such as improved competence of macroeconomic issues and the upgrade of traditional industrial marketing models, especially for the use of futures tools i.e. hedging and so on.

In 2019, the structure of the market has undergone profound changes, such as different trade and pricing patterns, and the diversification of market participants. Various capital and research and development companies that have been involved in establishing trade links began to adopt a pricing strategy influenced by the information and funds of said trade links, and have earned a stable rate of return.

In the spot market, traders who still had the resources or energy to spare started to enter the market again around the end of 2018. With the replenishment of spinners' stock and the depreciation of the yuan, profit margins were improved to an average of three to six percent, which has generally offset the losses sustained in 2018. The market also saw strong sales in 2018, influenced by declining prices.

Futures prices on the ZCE platform have been suppressed by the huge volume of certificated stocks of late, while prices in the physical market have been more stable. However, since early April, the price relationship between cotton and cotton yarn has gradually widened. Raw cotton is performing relatively better than cotton yarn, thanks to stimulation from a tax reduction policy. In early May, stocks held at Qingdao Port were estimated at 260,000 tonnes, comprising around 100,000 of Brazilian, 30,000 each of Indian and Western African, and the remainder of Australian and Mexican lint. US cotton stocks are still very small, especially as they are sold in yuan following customs clearance.

The main concern of trade participants is still the progress of Sino-US trade negotiations, which is related to exchange rate fluctuations and purchases of US cotton. Traders will also follow weather conditions (potential changes of output), State Reserve sales and procurement (one million tonnes of lots will be offered in total, while the timing, quantity and target of procurement is not confirmed), allocation of Sliding-Scale quota, the impact of imported yarn on prices, and the supply and demand situation (including the conflict between active demand and available supply).

However, all the above factors are unable to effectively guide industry players in dealing with potential changes in the future. The trade frictions between China and the US, in particular, are long-lasting and complicated, and the global economy is still in a weak state. However, there can be no victory in negotiations without advance planning and preparations. When and how the market conditions will be improved is influenced by many factors; we need to discover the core factor and then take opportunities to enter the market for verification. During the rest of 2019, the domestic and global economies will remain fatigued and weak, and potential volatility will occur, influenced by the above-mentioned trade disputes and high global debt. Against such a background, all domestic cotton textile industry participants in their 'tiny rowboats' need to lay solid foundations and prepare for the future. This means getting rid of the gambling mentality present in some enterprises, as well as destocking actively and buying and selling quickly, so as to prevent potential risks in the future. At the same time, participants should keep an eye on forward futures contracts and adopt a hedging strategy.

All opinions and suggestions are appreciated.





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Spot Trading in the Internet Era

Wang Bingnan, China National Cotton Exchange

Although it is a well-known tool in the cotton industry, the internet has also been criticized by many participants. In recent years, the concept of combining 'internet+trading' has been pursued by many innovative enterprises involved in physical cotton trading, and has facilitated disintermediation, resulting in a batch of cotton enterprises with internet-based businesses.

Those enterprises try to attract attention from cotton-related companies via cotton information 'push' services and inquiry services, and then by conducting transactions, hedging services, financing services and distribution services online, to achieve good levels of digital footfall and transaction flow. In this process, the internet often plays a supporting role but fails to accomplish a truly internet-based transaction model. Generally, those enterprises that do have their own online trading platforms aim to create a direct connection between ginners and spinners, in order to abandon intermediaries. However, this model eliminates the role of the merchant and does not conform to the accepted objective laws in cotton spot trading.

Fortunately, the integration of the internet and cotton has not stopped. Following a process of continuous innovation, difficulties, and innovation again, those cotton-related enterprises with internet-based concepts have realized after self-inspection that the essential attributes for cotton spot trading are as important as the concept of internet trading itself. It is therefore foreseeable that cotton spot trading via the internet will dominate the trading landscape in the next decade.

The essential nature of cotton spot trading includes a series of commercial actions taken with the purpose of accomplishing transactions. Here trading is a process rather than an action. In futures trading, meanwhile, both sellers and buyers enter into a standardized contract and both sides are able to hedge price risks, hence spot trading is conducted on the individual basis of each buyer or seller. In this sense, spot trading is far more complicated than futures trading.

Accurately understanding the core principles of spot trading is crucial to the establishment of said businesses in the internet era. With this understanding, many cotton enterprises with internet businesses will no longer pay attention only to the single action of a transaction, but will instead focus on the whole process of the transaction. By introducing internet platforms to the trading process, buyers and sellers will experience convenient and rapid information connections, speedy capital flow payments and contract performance guarantees, which will facilitate improved decision-making and operational efficiency. This is the core aim of the online development of cotton spot trading.

In this regard, the China National Cotton Exchange has built a set of data-based spot market foundations for the digital spot trading platform, including electronic warehouse receipts, warehouse video supervision, third-party inspections and the conclusion of contracts, payment, financing, delivery and so on online. It is through the export of these data and business standards that CNCE hopes to achieve the interconnection of traders.

Looking to the future, the monetary risks of cotton spot trading will continue to be hedged on the futures market, and the personalisation of spot trading services will be achieved by internet-based enterprises. It is conceivable that spot trading in the internet era will come to consist of the conclusion of contracts online, online capital payments and instant cargo ownership transfer. Combining the above business standards with virtual reality programmes should enable participants to model various business scenarios, thereby facilitating the most advantageous operational decisions. This kind of spot trading in the internet era will enable all the operators involved in the process of the transaction to interconnect and exchange information in real time, so as to realise an online ecosystem, achieving a kind of 'time and space travel' in cotton spot trading.

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Sailing with responsibility — Chinese overseas investment in textiles

*Zheng Jian, International Project Director, China National
Textile and Apparel Council*

Under the pressure of sluggish global economic and trade growth, and the persistent rise of domestic labor costs, the export-oriented Chinese textile and apparel industry has begun to look overseas for factory investment opportunities. Most of these enterprises are leading and large-scale companies in the industry. However, with the future implementation of the 'Belt and Road' initiative, establishing a business overseas seems to have become an irresistible option for many, and will provide domestic textile and apparel enterprises, including small and medium-sized companies, with a broader development path than was earlier available to them. As more Chinese textile and garment businesses engage in overseas investment, their behavior is increasingly concerned with global issues as well as domestic ones, in particular, the fulfillment of their social responsibilities in host countries.

The domestic textile and apparel industries took the lead in promoting the concept of corporate and social responsibility in China, and were some of the first to introduce corporate social responsibility management systems. However, in the process of 'going abroad', whether these enterprises can adapt to local laws and regulations, and achieve coordination with other relevant participants in order to fulfill their responsibilities, is the major issue for all parties. In particular, some countries are quite different as regards the political environment and level of social and economic development, which can create many uncertainties for businesses wishing to meet their social responsibilities.

In order to better understand the relationship between overseas investment and corporate social responsibility, the Social Responsibility Office of the China National Textile and Apparel Council (CNTAC) conducted a series of field surveys during 2016 and 2018. These concerned nearly 100 textile and apparel investors (based in places including Hong Kong, Macao and Taiwan), who have business investments in Bangladesh, Burma, Cambodia, Vietnam and Laos. A large amount of firsthand information was acquired, which truly reflected the social challenges encountered by overseas Chinese-funded enterprises.

Survey results show that in the main, Chinese textile and apparel enterprises conducting investment overseas are medium to large-sized companies with a majority of local employees, and most of the products produced are exported to Europe and the US with good profitability. At the same time, however, those enterprises are facing problems, such as an insufficient understanding of the local environment, a lack of professional staff, and an internationalization strategy that needs to be strengthened.

Although each host country has different economic, cultural and political backgrounds, said enterprises have displayed a series of common characteristics as regards social responsibility:

1. The companies surveyed generally have low awareness of corporate social responsibility and labor standards, as well as a lack of emphasis on public relations, education and training. For example, while visiting Cambodia in 2017, we found that only 60 percent of managers had heard of social responsibility and labor standards, while 85.7 percent of those enterprises had experienced

social responsibility (factory) inspections by foreign customers. Said managers generally believed that they had introduced enough initiatives such as equal pay for men and women, occupational safety assessments, paid holidays and so on. Around 90 percent of the employees said that their companies had already implemented policies and systems to protect their employee rights and welfare.

2. There is still much room for improvement in the standardization of employment. Although the signing rate of labor contracts is relatively high, and the proportion of employees working within the statutory hours regulations is satisfactory (at least 70 percent, according to survey data from Burma), most of the leadership positions are occupied by Chinese managers. Chinese-owned enterprises may therefore face serious problems as regards localization of management staff in the future.
3. The freedom of employees to negotiate collectively also presented a problem for enterprises investing in Burma, Cambodia and Bangladesh. Most of the Chinese managers were concerned about potential frequent strikes organized by external unions. In addition, the internal communication mechanisms of Chinese-owned enterprises were in need of strengthening. Taking the data from a survey conducted in Bangladesh during 2017 as an example, less than half of the employees interviewed stated that their employers had either coordinated or negotiated with a trade union.
4. Equality awareness in the workplace also needs to be improved. In terms of gender equality, most leaderships were focused on providing equal job opportunities for men and women, as well as offering labor protection for women, but failed to achieve the promotion of female managers or the establishment of a female-led employee organization. In addition, most of the employers differed in their understanding of 'gender equality'. For example, some continued to forbid women from being appointed to positions with higher incomes. This lack of awareness among management can lead to serious issues.
5. Communication with local stakeholders needs to be strengthened; most enterprises have formed or at least plan to form policies and commitments aimed at improving communication with interested parties. Employees and customers are the priority for most enterprises, followed by investors, trade unions and suppliers, and non-government organizations and local business associations. The most important issues include employee rights, safety, occupational health and environmental protection. However, enterprises are generally unaware of the importance of charity and community participation. In the past three years, only half of said enterprises have invested in charity and public welfare, plus the targets were mainly their own employees. Not enough investment has been made into community development, humanitarian aid, disaster relief and medical and health care, for example.



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CNTAC initiatives

As the representative of China's textile and apparel industry, CNTAC has been carrying out practical investigations into industrial and social responsibility since 2005. With the development of the 'Belt and Road' initiative, the Federation has further strengthened services and support for the sustainable development of enterprises, including conducting basic research and development, building capacity, consultation services and so on.

1. Theoretical research: in 2018, 'Guidelines for Responsible Overseas Investment in China's Textile and Apparel Industry' were published. As China's first investment guideline for conducting

business overseas, it emphasized the importance of responsible corporate behavior, which can help enterprises to better integrate global value chains, and ultimately contribute to the building of community as well as the realization of the United Nations' 2030 Sustainable Development Targets.

2. Regional cooperation: CNTAC establishes cooperation networks around the world, to introduce regional and global resources, and interested parties to target countries, to jointly build up a responsible global textile and apparel chain. Since 2017, CNTAC has conducted a series of cooperative projects to promote sustainable development and responsible corporate behavior around Asia. In terms of establishing regional networks, CNTAC has signed memorandums of cooperation with some local textile and apparel associations, such as the Burma Garment Manufacturers Association and the Cambodian Garment Association, to jointly promote the social responsibility of local enterprises.
3. Capacity building: based on extensive research conducted in the past few years, CNTAC has coordinated domestic and overseas resources to promote the sustainable improvement of capacity. Since May 2018, a total of six training programmes have been held in Cambodia and Burma with a focus on labor standards, cross-cultural management, the legal establishment of trade unions and gender equality. Managers from more than 60 Chinese-funded enterprises have participated in the training since its inception.

Within the framework of the "One Belt, One Road" initiative (under the Three-Year Action Plan for Overseas Sustainable Development of China's Textile and Apparel Industry 2018-2020), CNTAC will make further efforts to improve skills and training resources through regional networks. The focus will include the promotion of local cooperation in relevant fields, and improved dialogue between international stakeholders to jointly build a responsible and sustainable global textile and apparel value chain.

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China's Cotton Textile Industry Outlook

Wang Yan, CITIC Futures

In the past few years, China's cotton textile market has entered a period of three-pronged competition between Xinjiang yarn, 'mainland' yarn and imported yarn, instead of the former scenario in which domestic and imported yarn competed directly. Thanks to the availability of a large volume of State Reserve cotton for three consecutive years (from 2016 to 2018), the production costs of cotton textile enterprises in the 'mainland' have been lowered. This proliferation of local cotton yarn has impacted the competitiveness of imported yarns and domestic cotton textile enterprises have begun to earn the satisfactory profits that they have long hoped would materialize.

However, in the 2018/19 season, domestic reserve stocks declined to less than three million tonnes and China's cotton policy was significantly adjusted:

1. Following years of strict controls on imports of raw cotton, additional quota has been issued in recent years, amounting to some 1.6 million tonnes in the 2018 and 2019 seasons combined.
2. Sales of State Reserve cotton have been limited to around one million tonnes in total during 2019, and state procurement will be triggered when deemed appropriate.

Against the backdrop of these major adjustments to China's cotton policy, what challenges and changes will the domestic cotton and textiles market face? We believe that with the gradual reduction of competitive State Reserve stocks, domestic enterprises, especially in the 'mainland', will see their input costs greatly increased. The role of imported yarn is likely to develop

as a source of low-cost supply. Meanwhile, 'mainland' cotton and textile enterprises will be faced with the challenge of transforming and upgrading their business models yet again.

Rapid development of the Xinjiang cotton textile industry

The rapid development of Xinjiang's cotton textile industry began in 2011, when domestic companies were actively encouraged by the government to promote the transfer of work to the region. At that time, the Ministry of Industry and Information Technology and the Xinjiang Autonomous regional government jointly held the '2011 Xinjiang Industrial Transfer Linkup Event', and the accompanied 'Xinjiang Textile Industry Transfer Meeting', which accelerated the pace of industry movement to Xinjiang. The local government then formulated the 'Xinjiang Textile Adjustment and Revitalisation Plan', and developed the strategic layout of 'two cities, seven parks and one center', namely the Aksu and Shihezi Textile Cities, seven key textile industrial parks and the Urumqi Textile and Garment International Trade Center. According to the plan, by 2023, Xinjiang's cotton textile capacity will reach 20 million spindles.

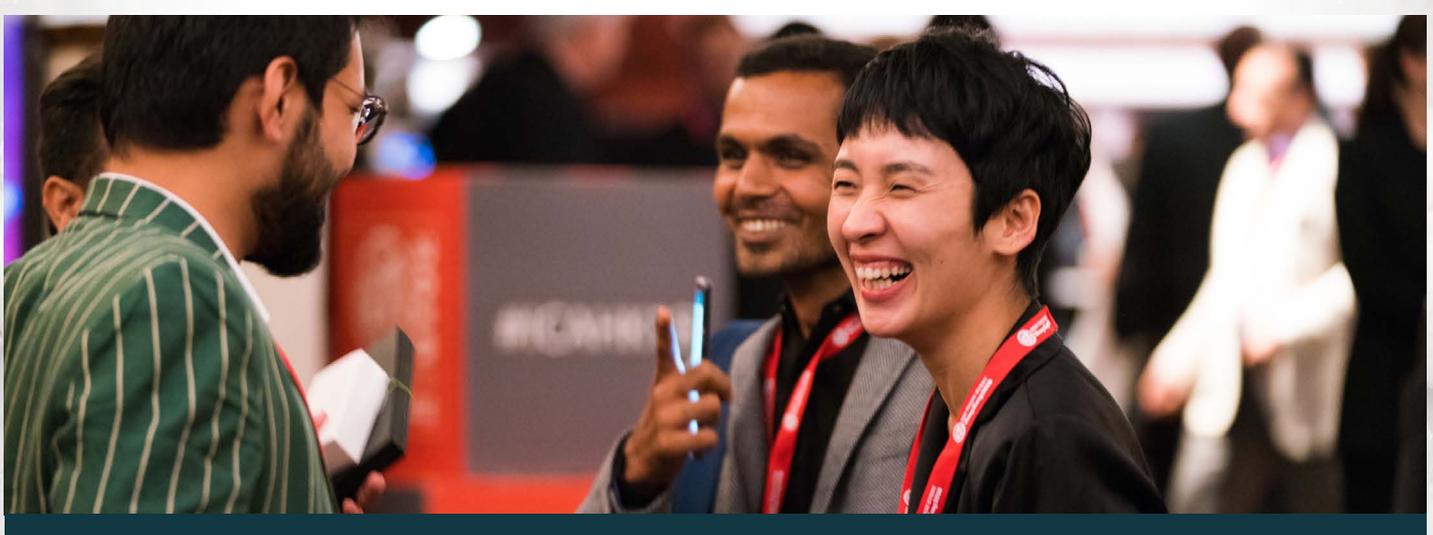
By the end of 2017, spindleage in Xinjiang was 17.46 million. As things stand, the region's cotton textile capacity is very likely to exceed the above-mentioned 20 million spindles if no measures are taken to control the rise. As a result, in the first quarter of 2018 the Xinjiang Autonomous government issued the 'Emergency Notice on Strictly Controlling the Disorderly Development of the Cotton Textile Industry'.



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It is anticipated that as capacity in Xinjiang approaches 20 million, cotton consumption and cotton yarn production in the region will tend to stabilise. Given Xinjiang's position as China's main producing area, and the incentivizing effect of cotton yarn movement subsidies, low to medium-count yarns will remain the main production varieties in Xinjiang, and such products will remain in competition with imported yarn.

Mainland cotton textile industry struggles to stay alive

A large volume of Xinjiang yarn has entered the 'mainland' in recent years, due to the rapid expansion of cotton textile capacity in Xinjiang. Mainland cotton textile enterprises have therefore operated with the remnant share of a market that is now dominated by Xinjiang yarn and imported yarns.

Between 2016 and 2018, a total of 8.4 million tonnes of State Reserve cotton was offered to market, and most of the stocks were mainland cotton, bringing a level of profit that had not been seen for some years to enterprises based in eastern provinces. In 2019, the State Reserve sale will offer a quantity of one million tonnes, and state procurement will occur when it is considered appropriate.

In fact, after several rounds of huge price fluctuations in the cotton market, mainland enterprises have made great progress in risk-control and the characteristics of their production varieties; a shift to high value-added, high technology products and utilization of industrial clusters was accomplished.

Positive interaction between imported yarn and the domestic cotton textile market

In April 2019, China granted zero-tariff trade to a total of 313 items imported from Pakistan, including cotton yarn, cloth, woven and knitted garments and home textile products.

China mainly imports yarn from Asian countries such as India, Pakistan and Vietnam. So far, yarns from Pakistan and Vietnam are on the list of zero-tariff treatment, and a 3.5 percent tariff is levied on Indian yarn.

Data show that during 2002/03, China imported 650,000 tonnes of cotton yarn. The figure had reached 1,110,000 tonnes by 2009/10, and hit a high point in 2014/2015, at 2,330,000 tonnes. Because the State Reserve sales began soon after that, the competitiveness of mainland cotton textile enterprises has been strengthening and China's yarn imports have declined to some extent. However, the volume imported per season remains at around two million tonnes. Some of the domestic textile enterprises that have established factories in other Asian countries are the main sources of China's cotton yarn imports.

We predict that with the continuous development of the cotton textile industry in Asian countries, as well as the advancement of labor-intensive industries such as the garment sector, cotton consumption and yarn production in most Asian countries will maintain an upward trend in the future.

Outlook

As the de-stocking of State Reserve cotton comes to an end, and China's import quota policy remains close to to the actual demands of domestic enterprises, we expect that the predictability of China's cotton policy will be enhanced, and the relationship between cotton prices at home and abroad will be more closely linked.

Meanwhile, with the continuous development of the cotton textile industry in Asia, the structure of the entire textile and apparel chain will form a situation of mutual advantage.

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