

Agricultural Outlook Forum 2007

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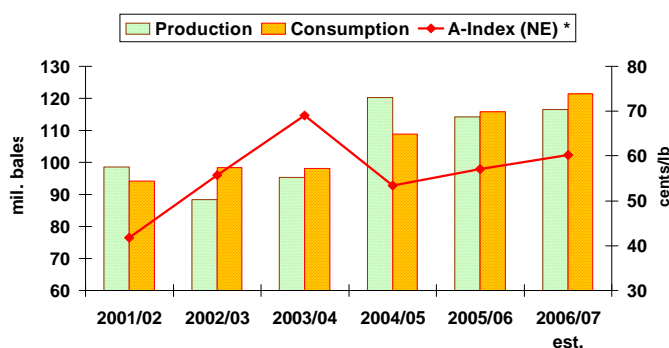
THE UNITED STATES AND WORLD COTTON OUTLOOK

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Introduction

A combination of moderately higher world production and sharply higher world consumption is reducing world stocks for the 2006/07 season. Significant increases in production for China, India, Brazil, and Turkey will more than offset reduced production in the United States, Australia, Greece, and Syria. World cotton consumption is estimated to grow nearly 5 percent, making 2006/07 the third consecutive season of growth above the long-run average. Led by China, global consumption continues to be sustained by strong world economic growth, a reduction in textile trade barriers, and favorable cotton prices relative to polyester. Accordingly, world stocks are forecast to decline nearly 3 percent to about 53 million bales. The A-index (Northern Europe) averaged 60.25 cents per pound from August 2006 – January 2007, an increase of nearly 6 percent from the 2005/06 average. For 2007/08, stable world production and continued growth in consumption are projected to reduce world stocks for the third consecutive season.

World Production, Consumption, and Prices
2001/02 to 2006/07



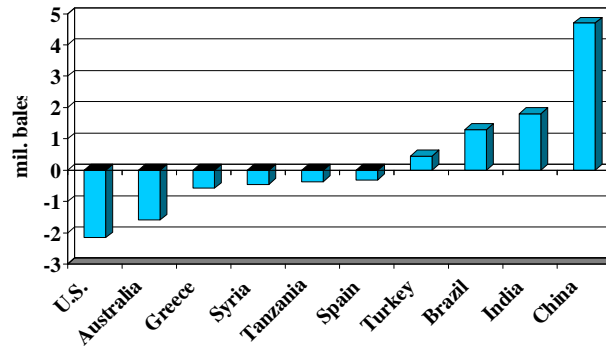
*2006/07 Aug-Jan avg.

World Cotton Situation, 2006/07

World Cotton Production, 2006/07

World cotton production rose 2 percent in 2006/07, to 116.6 million bales, its second highest ever. Larger crops in China, India, Brazil, and Turkey offset declines in the United States, Australia, Greece, and Syria.

**Estimated Changes in World Production,
2006/07 vs. 05/06**



China's area partly rebounded in 2006/07 in response to cotton prices the previous year. With a 6-percent gain in area, the rebound was smaller than the increase in prices. China's cotton yield in 2005/06 remained below its long-term trend for the third year in a row, which may have affected producers' outlook on expected returns. At 5.4 million hectares, China's cotton area remained 6 percent below 2004/05's 12-year high. However, very favorable harvest weather resulted in sharply higher yields and China's cotton crop was the highest ever. China's cotton yields rose 12 percent from the year before. Production rose 4.7 million bales to 30.9 million, according to China's National Bureau of Statistics (NBS).

For India, both area and yields rose in 2006/07 from the year before, as the ongoing adoption of genetically engineered Bt cotton continued transforming cotton cultivation across the country. The opportunity to cultivate Bt varieties that yield 40 percent more than even hybrid varieties has drawn additional area into cotton production. As the proportion of India's cotton devoted to Bt-varieties grows, the country's average yield grows as well and, like China, India's 2006/07 cotton crop was its largest ever. Production rose 1.8 million bales, or 9 percent, to 21 million bales.

Brazil's 2006/07 estimated production increase of 1.3 million bales is smaller than India's in absolute terms, but represents a 28-percent gain. With a Southern Hemisphere crop cycle, planting intentions in Brazil were influenced by the increase in cotton prices during August-December 2006 compared with the same period a year earlier. In contrast, soybean prices in Brazil declined significantly, and area planted to cotton rose 21 percent, led by gains in Mato Grosso. Higher yields are also expected, and production is forecast to reach 6 million bales.

Australia's crop also follows the Southern Hemisphere's crop cycle, but a severe shortfall of precipitation has prevented producers from responding to prices in line with Brazilian producers. At 145,000 hectares, area for Australia's cotton crop is forecast 57 percent lower than last season and the lowest level in decades. The absence of rainfall at planting hit dryland cotton particularly hard. Irregular water supplies and poor rainfall for the growing season to date could negatively affect the yields of irrigated cotton, but Australia's total average yield is expected to be similar to the previous year's due to the virtual absence of lower-yielding dryland cotton. At 1.2 million bales, Australia's crop would be its smallest in 20 years.

Weather-reduced yields also accounted for much of the reduction in production for Greece and Syria, but in the United States, lower harvested area accounted for most of the 2.2-million-bale decline (see U.S. section).

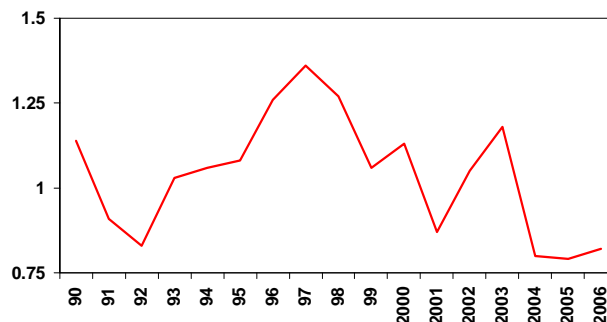
World Cotton Consumption, 2006/07

In a third consecutive season of robust growth, world cotton consumption is expected to rise 2.5 million bales in 2006/07, a nearly 5-percent increase that will bring world consumption to just over 121 million bales. In the ten years from 1994/95 to 2003/04, world cotton consumption grew at an average rate of 1.4 percent. However, consumption growth averaged 9 percent for the 2004/05 and 2005/06 seasons, which has effectively doubled the ten-year average to about 3 percent.

Growing world incomes, favorable relative fiber prices, and the continued benefits from the end of the Multifibre Arrangement (MFA) are all factors supporting strong world cotton consumption. Real world gross domestic product (GDP) grew an average of 3.9 percent during the three years 2004-2006, about double the average for 2001-2003. GDP is growing much faster than the world average in developing countries, such as China and India, which have large populations and low per capita cotton consumption. Rising demand by consumers in these countries is an important factor boosting global consumption.

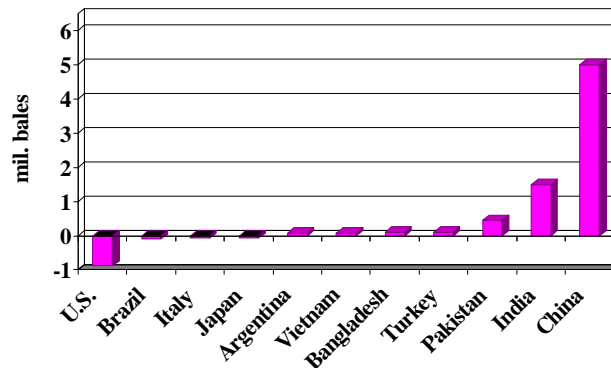
Cotton prices have continued to be competitive relative to polyester. While cotton prices have risen during the first half of 2006/07, polyester prices have strengthened as well. Cotton has given up some of its price advantage with respect to polyester, but global synthetic fiber prices have been supported by increased petroleum prices. Compared with 5 and 10 years earlier, cotton is priced much more favorably for consumers relative to synthetic fibers.

World Cotton-to-Polyester Price Ratio
(Source: Cotton Outlook)



The most striking increases in world mill use of cotton in 2006/07 continue to be in the countries benefiting the most from the end of the MFA in January 2005: China (+10 percent), India (+9 percent), and Pakistan (+4 percent). These three countries collectively are expected to raise consumption by nearly 7.0 million bales, compared with the world total increase of 5.5 million. Declining consumption in developed countries, especially the United States, but also in Europe and Asia, is partially offsetting.

**Estimated Changes in World Consumption,
2006/07 vs. 05/06**



China's expected 10-percent increase in mill use to 50 million bales brings it to just over 40 percent of total world consumption. In addition to the lowering of trade barriers, factors supporting spinning consumption in China include investment in infrastructure, economies of scale, and integration with the world's largest and most dynamic textile manufacturing industry. A detailed analysis of several indicators of China's rising consumption is included in a separate paper presented at the 2007 Outlook Forum, *Progress and Problems in Estimating China's Supply and Demand*, by Stephen MacDonald.

China's Domestic Consumption and Trade

An estimated 5-million-bale increase in 2006/07 China consumption is about offset by the larger crop, such that the gap between production and consumption of just over 19 million bales approximates that of last season. China imported a record 19.3 million bales in 2005/06; however, imports for the first half of the current season have fallen well short of the year-ago level.

China Cotton Balance Sheet

	mil. bales	
	<u>2005/06</u>	<u>2006/07</u>
Beg. Stocks	13.1	15.7
Production	26.2	30.9
Imports	<u>19.3</u>	<u>15.5</u>
Total Supply	<u>58.5</u>	<u>62.1</u>
Consumption	45.0	50.0
Exports	<u>0.0</u>	<u>0.1</u>
Total Use	<u>45.0</u>	<u>50.1</u>
Residual	-2.2	-3.0
Ending Stocks	15.7	15.0

The primary factor slowing the pace of imports appears to be government-imposed import quotas, which have been more restrictive thus far this season than last. The last tariff rate quotas (TRQ's) issued for calendar 2006 were 700,000 tons released in the early fall; these TRQ's were subject to new duties and restrictions which made them relatively less attractive. In January 2007, the WTO TRQ of 894,000 tons (4.1 million bales) was released; however, because a portion of the quota is reserved for State

enterprises, it has not all been allocated to mills. And the government has made clear that any additional quotas will not be allocated before March and possibly later. China has used a sliding scale import duty on non-WTO TRQ imports that attempts to assure a minimum import price to help support the domestic price for cotton. Beginning with any new non-WTO TRQ in 2007, China changed the sliding scale to raise the minimum import price and to tighten implementation to assure that the minimum price is actually met.

The apparent goal of the more restrictive import policies is to use domestic cotton first before allowing significant imports. There is evidence suggesting that China's government faced an unanticipated accumulation of stocks, especially from Xinjiang, in the late summer of 2006. At that time, ad hoc measures were undertaken to move the surplus Xinjiang cotton to market. Since then, additional measures, including purchases for the national reserve and preferences for rail transport to eastern China, have been adopted, apparently to ensure a more expeditious disposition of the 2006 Xinjiang crop.

The government-imposed constraints on imports have made it difficult to ascertain the underlying demand from the world's largest cotton consumer and importer; this, in turn, has resulted in unusual uncertainty for the world cotton market. The balance sheet indicates that China's mills will need large quantities of imports to continue operating before the 2007 crop becomes available and, therefore, are likely to duplicate the record monthly import levels seen in the late spring of 2006. However, balance sheet analysis has not always proven a reliable indicator of prospective China imports, due mainly to discrepancies between production and consumption indicators. USDA has included a residual factor of 3.0 million bales in its 2006/07 China balance sheet to account for unexplained supply. Accordingly, imports are now forecast at 15.5 million bales, despite the 19.0 million bale consumption-to-production deficit. Stocks are forecast to decline to 15.0 million bales, reflecting a tightening of 5 percentage points in the stocks-to-use ratio to 30 percent.

World Trade, Ending Stocks, and Prices

World Cotton Balance Sheet

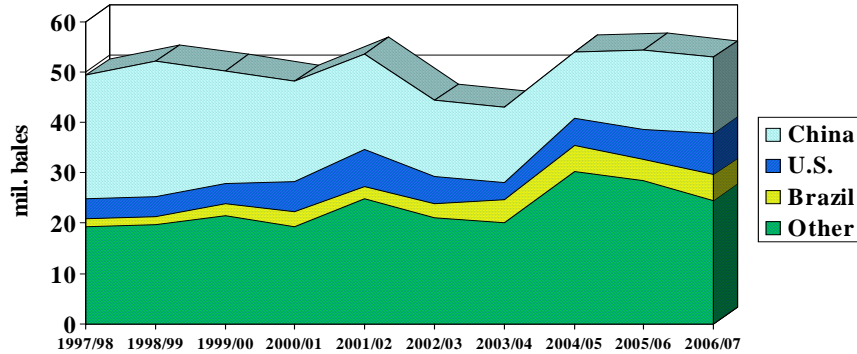
(mil. bales)

	<u>2005/06</u>	<u>2006/07</u>
Beg. Stocks	53.9	54.3
Production	114.1	116.6
Imports	<u>44.0</u>	<u>40.5</u>
Total Supply	<u>212.1</u>	<u>211.4</u>
Consumption	115.8	121.3
Exports	<u>44.6</u>	<u>40.0</u>
Total Use	<u>160.4</u>	<u>161.3</u>
Residual	-2.6	-2.9
Ending Stocks	54.3	52.9

Total 2006/07 import demand in the world is declining by 8 percent to 40.5 million bales, mainly reflecting lower imports by China. Outside of China, foreign countries in the aggregate will draw down stocks rather than raise imports to sustain slightly higher demand. World ending stocks are forecast at nearly 53 million bales for 2006/07, slightly below the year-ago level. The forecast world stocks-to-use ratio of 43.6 percent would be 3 percentage points lower than last season, and reflects a continuing gradual decline from the beginning of the decade, when China held large stocks. The A-index (Northern

Europe) has averaged about 60 cents per pound thus far this season, compared with 57 cents for 2005/06 and 53.5 cents for 2004/05.

U.S., China, Brazil, & Other Foreign Stocks through 2006/07



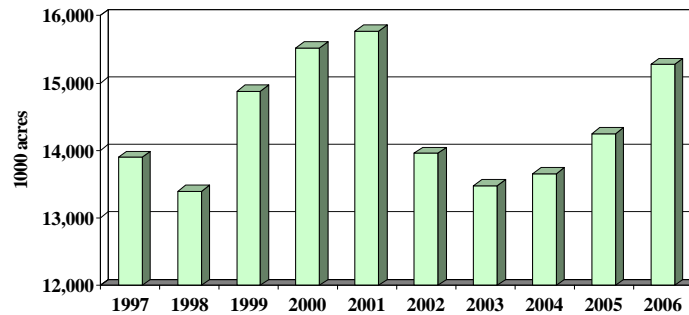
U.S. Cotton Situation, 2006/07

Area and Production

As planting time approached for the 2006 crop, U.S. harvest futures prices for cotton and competing crops—like corn and soybeans—were each above their year-ago levels. However, relative prices favored cotton over corn and soybeans. With prices above their respective loan rates and favoring cotton, planting decisions in 2006 were based largely on market return expectations. Also, high cotton yields in many areas of the Cotton Belt in 2004 and 2005 likely played a critical role in boosting 2006 area.

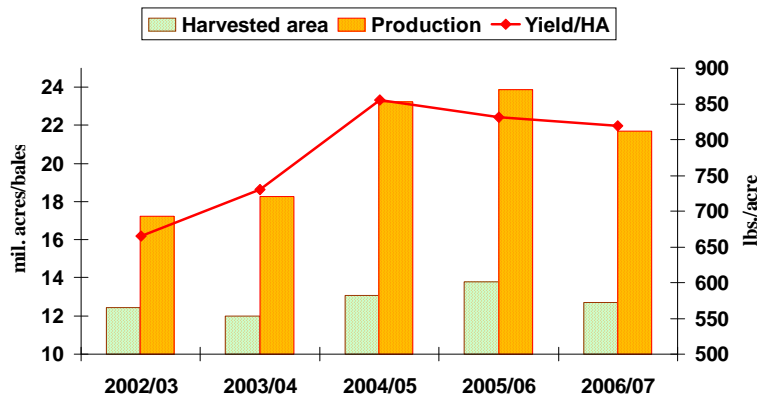
U.S. cotton area in 2006 surpassed both the 2005 area and the March 2006 *Prospective Plantings* indication. U.S. producers planted nearly 15.3 million acres of cotton in 2006, 7 percent above a year earlier and the highest in 5 years; plantings were also 4 percent above indications in the *Prospective Plantings* report. Upland cotton area totaled 14.9 million acres, nearly 1 million (7 percent) above 2005 and the most planted under the current farm legislation. Meanwhile, extra-long staple (ELS) acreage climbed 20 percent to 326,000 acres, as demand and prices remained relatively high; most of the ELS increase occurred in California where nearly 90 percent of the crop is grown.

U.S. Cotton Planted Acres 1997-2006



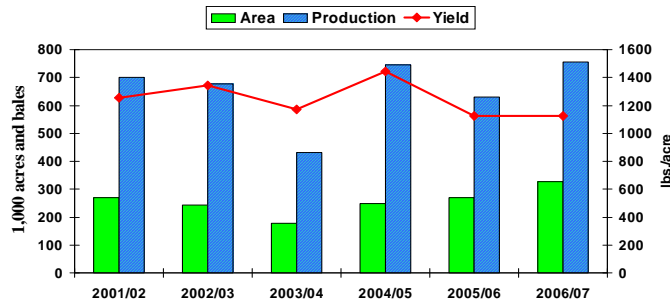
Despite larger U.S. cotton plantings this season, harvested area in 2006 declined to its lowest in 3 years as the lack of adequate rainfall throughout much of the Southwest region raised abandonment sharply. The abandonment rate for the Southwest jumped to nearly 36 percent, the highest since 41 percent was recorded in 1998; nationally, the abandonment rate approached 17 percent. As a result, 2006 harvested area reached only 12.7 million acres, 8 percent below 2005 and the smallest in 3 years.

U.S. Harvested Area, Production, and Yield 2002/03 to 2006/07



U.S. cotton production in 2006/07 is estimated at 21.7 million bales, compared with last season's record of nearly 23.9 million bales. The 2006/07 season marks the third consecutive year with over 21 million bales of cotton produced in the United States. This season's production was quite different, however, than the previous two years as growing conditions were much less favorable. Crop conditions in 2006 were well below the past two seasons and the 5-year average. However, the recent technological advances—including variety improvements, biotechnology, and the success of the boll weevil eradication program—have pushed yields to a higher level. The U.S. yield is estimated at 819 pounds per harvested acre in 2006/07, topped only by 2004/05's record of 855 pounds and last season's 831 pounds. Upland production is currently estimated at about 21 million bales, with an average yield of 811 pounds per harvested acre. The ELS crop is projected higher at a record 756,000 bales, as the yield averaged 1,122 pounds per harvested acre, near the 2005/06 yield.

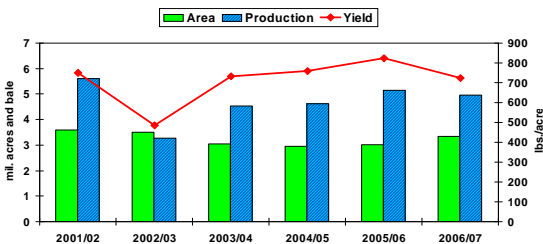
ELS Cotton Area, Production, and Yield 2001/02 to 2006/07



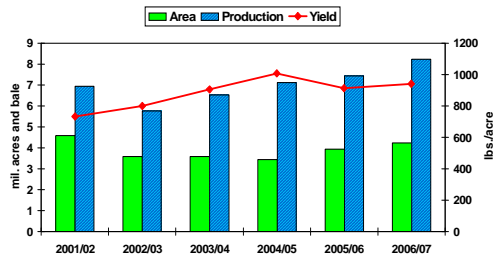
Compared with last season, 2006/07 upland cotton production was lower in three of the four Cotton Belt regions. The exception was the Delta region, where a record crop of 8.2 million bales is estimated. The combination of the largest area in 5 years, a very low abandonment, and the second highest yield on record (942 pounds per harvested acre) pushed the Delta crop to new heights as the region accounted for 40 percent of the U.S. upland crop in 2006/07. In contrast, the Southwest saw a significant decline as 2.4 million acres were not expected to be harvested, resulting in the lowest cotton harvested area in the region since 1998/99. The upland crop is estimated at 6.3 million bales, more than 2.5 million below 2005/06, with a regional yield of 692 pounds per harvested acre. The Southeast region produced a slightly lower crop in 2006/07 at roughly 5 million bales, accounting for just under one-fourth of the U.S. upland cotton area and output. Harvested area was the highest in 5 years while the average yield of 723 pounds per harvested acre was the lowest in 4 years.

In the West region, upland area fell to 525,000 acres—the region’s lowest since 1935/36—as upland area there continues to follow a downward trend since the early 1980s. With the lower area and an average yield of 1,323 pounds per harvested acre, upland production in the West this season contributed only 1.4 million bales or 7 percent of the total upland crop in 2006/07. The ELS crop—produced largely in the West—had a below-average yield which was offset by higher acreage. ELS production continues to be dominated by California, where nearly 90 percent of the 2006 ELS cotton crop was produced.

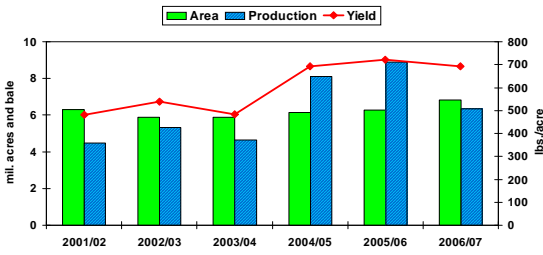
Southeast Region Upland Cotton Area, Production, and Yield 2001/02 to 2006/07



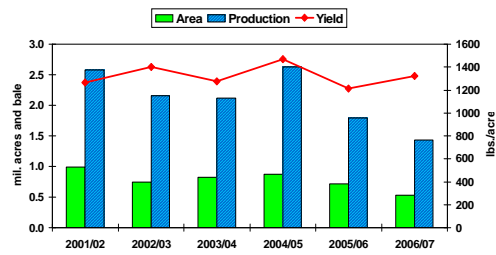
Delta Region Upland Cotton Area, Production, and Yield 2001/02 to 2006/07



**Southwest Region
Upland Cotton Area, Production, and Yield
2001/02 to 2006/07**



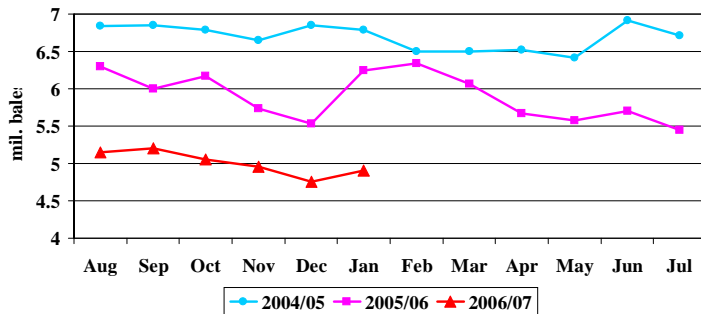
**Far West Region
Upland Cotton Area, Production, and Yield
2001/02 to 2006/07**



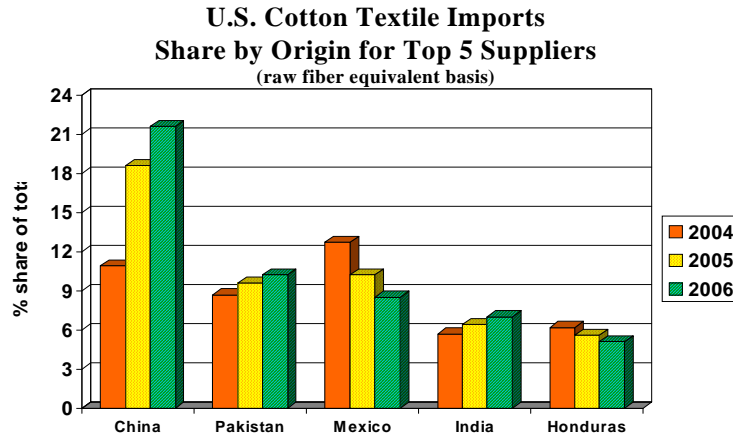
Domestic Mill Use

Domestic mill use is forecast at 5 million bales for 2006/07, 900,000 bales or 15 percent below a year earlier. The current projection is less than half the level seen just 7 years ago in 1999/2000 and is expected to be the lowest since 1931/32.

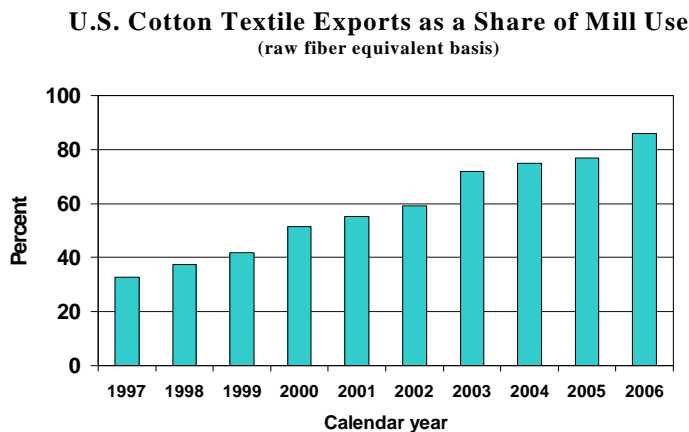
**Seasonally Adjusted Annual Mill Use Rates
by month since August 2004**



This dramatic decline in U.S. mill use has resulted from increased competition of imported textile and apparel products over the last several years as quotas were phased out. With the final apparel quotas lifted in January 2005, the U.S. textile industry faced additional pressure from imported products, particularly from China. In calendar year 2005, China replaced Mexico as the leading supplier of cotton textile and apparel products to the United States, accounting for about 19 percent of the 2005 total. In 2006, China's share continued to grow, accounting for about 22 percent of all cotton textile and apparel imports. In addition, Pakistan surpassed Mexico to become the second leading import source. Pakistan contributed 10 percent of total cotton product imports compared with Mexico's 8.5 percent.

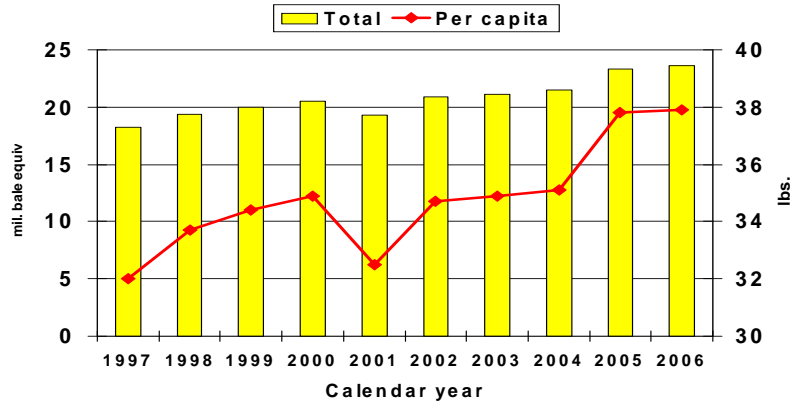


The overall volume of U.S. textile trade rose once again in calendar year 2006. The U.S. textile trade deficit also expanded, as cotton product imports increased and product exports decreased slightly. The cotton product trade deficit in 2006 expanded to a record 18.1 million bale-equivalents, more than double the trade deficit of just 8 years ago. During 2006, U.S. cotton textile and apparel imports reached the equivalent of 22.8 million bales of raw cotton, 4 percent above 2005. In contrast, cotton product exports decreased slightly to 4.7 million bale-equivalents in 2006, and now account for 86 percent of U.S. cotton mill use compared with 55 percent in 2001. The expanding proportion of mill use that is exported in the form of products is indicative of the continuing decline of the U.S. textile and apparel industry.



Along with the expansion of imported cotton products, U.S. retail use of cotton, as measured by domestic mill use plus net textile trade, is expected to rise again in 2006/07 if the 2006 calendar year trend continues. In 2006, U.S. domestic consumption of cotton climbed to 23.6 million bale-equivalents, up from 23.3 million in 2005. U.S. consumers continue to support global demand for cotton, as U.S. per capita cotton consumption rose marginally in 2006 to an estimated 37.9 pounds per person.

U.S. Domestic Cotton Consumption: Total and Per Capita

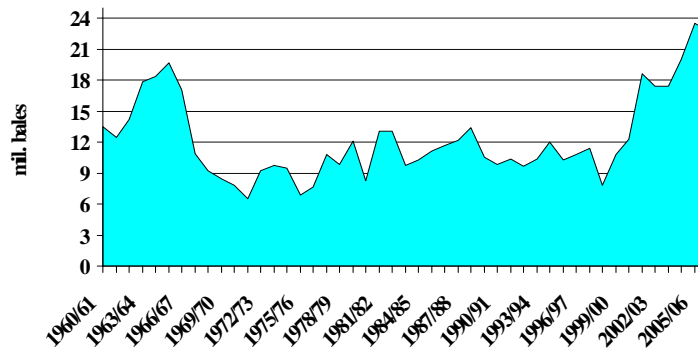


Exports and Ending Stocks

USDA is forecasting total 2006/07 U.S. exports at 14.5 million bales, down 20 percent from last year’s record of 18.0 million bales, but still the second highest on record. The large 2006/07 crop following two consecutive record U.S. crops, combined with ongoing reductions in domestic mill use, has resulted in the second largest exportable supply in 100 years.

US Exportable Supply Second Highest in over 100 Years

(exportable supply = total supply - mill use)



However, reduced import demand by China and the loss of Step 2 payments are forecast to result in more of that supply carried forward to the 2007/08 season. U.S. upland cotton exports of 13.8 million bales are expected to be lower than last season’s record 17.4 million bales. In contrast, with higher beginning stocks, record production and declining mill use, ELS cotton exports are expected to increase by 17 percent from last season to 700,000 bales.

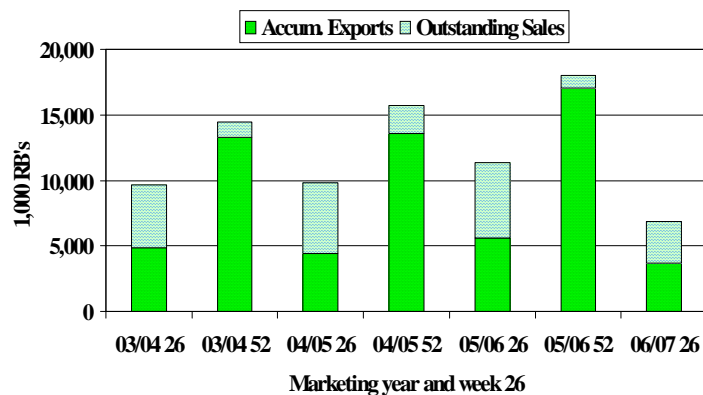
U.S. Cotton Supply-Demand Estimates

mil. bales

	<u>2005/06</u>	<u>2006/07</u>
Beg. Stocks	5.5	6.1
Production	23.9	21.7
Imports	<u>0.0</u>	<u>0.0</u>
Total Supply	<u>29.4</u>	<u>27.8</u>
Consumption	5.9	5.0
Exports	<u>18.0</u>	<u>14.5</u>
Total Use	<u>23.9</u>	<u>19.5</u>
Ending Stocks	6.1	8.3

Shipments from the United States in the first half of the season of 3.8 million 480-lb. bales are significantly below last season's record 5.8 million, and are the lowest in six years. Total sales commitments as of January 25, 2007 were 40 percent below the year-ago level.

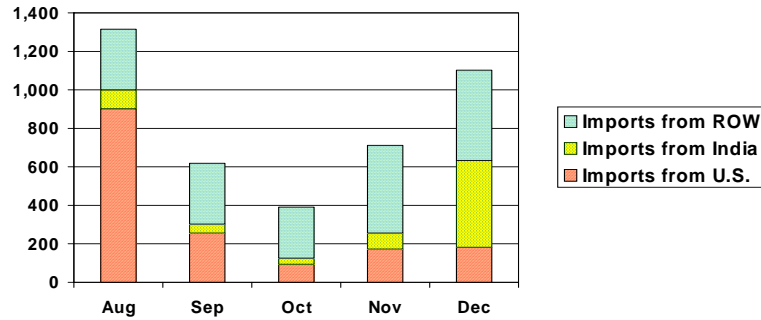
Total Export Commitments
as of Weeks 26 and 52



Sales commitments to destinations outside of China are marginally behind, but commitments to China are nearly 5.0 million bales lower. Weekly exports have averaged 145,000 bales, 35 percent below the average for the same period the last year. The season forecast of 14.5 million bales assumes that weekly exports for February-July will be quite strong, averaging about 405,000 bales per week. However, this would still be about 30,000 bales per week below the comparable average for 2005/06.

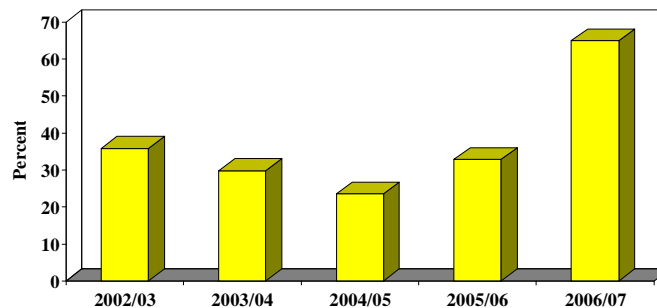
Weak demand from China resulting in lower overall world imports is the primary factor constraining U.S. exports; however, it also appears that the U.S. is losing share in the all-important China market. Large crops produced in India for 2004 through 2006 have generated significantly larger exportable supplies, and competitively-priced Indian cotton has become a major source of Chinese imports in recent months. With the loss of the Step 2 program, U.S. cotton has become more expensive relative to Indian and some other world cotton growths, and the U.S. share of world exports is now forecast to decline from its recent average of about 40 percent to just over 36 percent in 2006/07.

**China's Imports by Month since August 2006
with U.S. and India Shares**
(1000 bales)



Loss of export market share has coincided with a significant volume of cotton held in the Commodity Credit Corporation (CCC) loan program. As of the end of January, about two-thirds of the 2006 upland cotton crop was outstanding under CCC loan, more than double the normal level. In the absence of Step 2 payments, the differential between U.S. nearby futures prices and the adjusted world price (AWP) has to date not provided an adequate incentive for loan redemptions.

**Percent of Upland Cotton Production
Outstanding under CCC Loan on February 1**

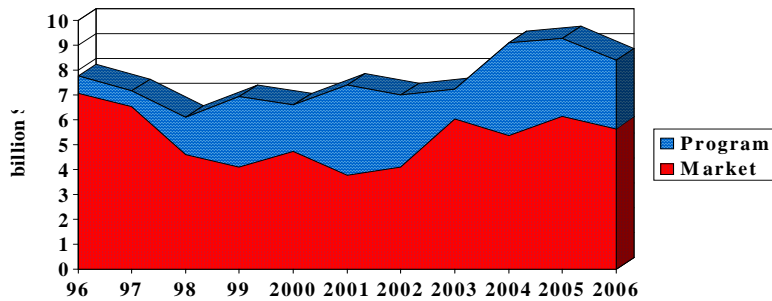


U.S. ending stocks are forecast at 8.3 million bales this season, up more than 37 percent from 2005/06, and the highest level since 1985/86. At this stock level, the U.S. would hold about 16 percent of global stocks, an increase of 5 percentage points from last season. The U.S. stocks-to-use ratio would grow substantially from last season's 25.3 percent to 42.6 percent, and would be the highest since 1988/89. Upland stocks are estimated at 8.2 million bales, while ELS stocks are expected to be 110,000 bales.

Prices and Farm Income

Gross upland cotton farm income from the 2006 crop is estimated about ten percent below 2005 at \$8.4 billion. Slightly higher prices are not likely to be sufficient to offset the smaller size of the crop, lowering market income eight percent to \$5.6 billion. Program payments fall 12 percent as the smaller crop and higher prices reduce marketing loan gains. The upland cotton marketing year price has averaged 47.2 cents per pound for August through December 2006, an increase of less than one percent from the 2005/06 average.

Gross Cotton Farm Income 1996/97 through 2006/07 est.



World Cotton Outlook, 2007/08

World Production, 2007/08

Little change is foreseen from the year before for world cotton production in 2007/08, which is forecast at 117 million bales. Higher world cotton prices during the first half of the 2006/07 marketing year might ordinarily signal increased cotton area during the following year, but 2006/07 has proven to be anything but ordinary. With high oil prices and burgeoning demand for corn by ethanol producers, corn prices in 2006/07 are forecast 50 percent higher than the year before. Wheat, soybean, and rice prices are also forecast higher; however, changes in world cotton production next season are more likely to result from changes in policy and technology than price.

China's cotton production is projected about unchanged at 31 million bales for 2007/08. China's extensive and complex system of import quotas and government cotton reserves has limited the correlation between price movements in China and the rest of the world in 2006/07. In contrast with world cotton prices, internal cotton prices fell 10 percent during the first half MY 2006/07, as China's large cotton crop boosted domestic supplies. However, China's corn prices have risen strongly, as they have in world markets, and prices for other crops are higher as well. These price movements would be expected to reduce the attractiveness of cotton cultivation, and reduce China's cotton area. On the other hand, the 2006/07 surge in China's cotton yields probably altered producers' expectations of likely future yields, and may have provided them with more resources to finance next year's crop. Subsidies to cotton production are also being put in place in China, and the government has frequently intervened in local markets, buying cotton for the government's reserves. Surveys have shown interest by China's cotton farmers in expanding planted area in several provinces, although China's powerful National Development and Reform Commission (NDRC) recently forecast that cotton area would instead fall in a number of provinces. Even if cotton area rises, production is likely to be unchanged as yields in eastern China fall to more normal levels. Yields have been trending upwards in both Xinjiang and in eastern China, but unusually favorable harvest weather provided an additional boost to yields there in 2006/07, and normal weather would therefore mean lower yields.

U.S. cotton production is expected to fall 1.7 million bales, in large part due to changes in relative crop prices (see U.S. section). As U.S. production drops to 20 million bales, India's crop is likely to surpass the 21 million bales expected in 2006/07, and replace the United States as the world's second largest

cotton producer. Since much of the Bt cotton planted in India is illegal, estimates of the extent of Bt adoption vary widely. Bt cotton has probably surpassed the 50-percent adoption point, and while its share of India's cotton area is almost certain to continue growing, its growth should be slowing. In 2007/08, India's cotton yield is likely to continue rising as Bt cotton spreads, raising production even if total cotton area is constant.

Higher production is also expected in Pakistan in 2007/08 as more normal weather and the spread of Bt cotton boosts yields. Commercial cultivation of Bt cotton is not legal in Pakistan, but has reportedly spread to several 100,000 hectares. Assuming continued growth in area planted to Bt varieties, Pakistan's cotton yields and output can be expected to rise, assuming normal weather. Yields in Pakistan's Sindh would also be expected to rise from 2006/07, when unusually high summer rainfall reduced output.

More normal weather for Australia in 2007/08 would permit producers there to increase cotton area and production. Irrigated yields in Australia have risen in recent years, but if dryland planting returns to a more normal share of the crop, then Australia's 2007/08 yields could be unchanged from or even lower than 2006/07 yields. A 100,000-hectare increase in area—like the one that occurred in 2004—would translate into an increase in production of up to 1 million bales.

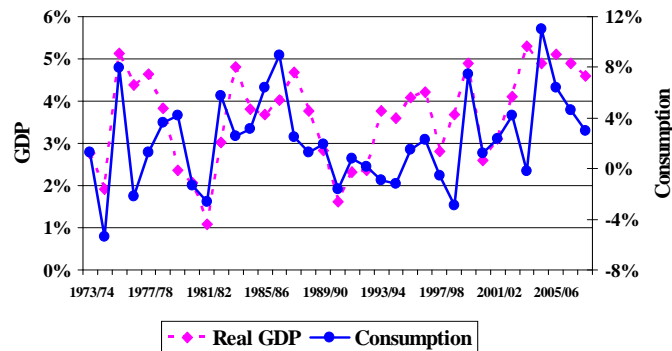
Production in West Africa's Franc Zone in 2007/08 is likely to be about unchanged compared with the year before. Local corn prices in the Franc Zone countries are not strongly linked with surging world corn prices, limiting the impact increased world ethanol production on the region's cotton sector. Cotton prices were higher in US dollar terms during the first half of marketing year 2006/07, but for the Franc Zone, this was offset by strength of the Euro versus the U.S. dollar. A rebounding EU economy drove the Euro 8 percent higher with respect to the dollar, and the CFA Franc is linked to the Euro.

World Cotton Consumption, 2007/08

World cotton consumption has grown at an extraordinary rate since the end of the 1990's. Global income growth has been its most robust since the early 1970s, and cotton prices have been their lowest relative to polyester prices since the mid-1980s. During marketing years 2001/02-2006/07, annual growth in world cotton consumption averaged 5.1 percent, and growth during the last 3 years was the fastest since at least 1960.

In 2007/08, conditions still favor an increase in consumption above the long-run average, but at a lower rate approximating the most recent 10-year average. World cotton consumption is expected to grow by 3 percent in 2007/08, reaching 125 million bales. World GDP growth in calendar years 2007 and 2008 is expected to be a little slower than in 2006, although still above average. During the first half of 2006/07, world cotton prices have risen, marking the third consecutive year of rising cotton prices. While higher cotton prices would be expected to have a negative impact on the level of cotton consumption, polyester prices have also risen, offsetting part of the impact of rising cotton prices.

2007/08 World Consumption Growth Slows



Another indicator of the likely strength of world cotton consumption's growth in 2007/08 is the continued high investment in China's textile industry, and the growing investment in India's textile industry. While some of the expected gain in spinning capacity in these two countries will be offset by reduced spinning elsewhere in the world, China and India together now account for more than half of the world's cotton spinning, which limits the capacity of other countries to make significantly offsetting cuts. Furthermore, during 2006/07, consumption showed some signs of stabilizing in Western Europe, Turkey, and a broad range of Asian countries. U.S. mill use declined significantly during 2006/07, but much of the rest of the world has demonstrated some resilience in the face of rapid increases in cotton consumption by China, India, and, to a lesser extent, Pakistan.

USDA's long term baseline projections show world growth in cotton consumption slowing to a little below 2 percent annually in the long run, much closer to the long run historical rate of growth observed since 1960. However, for 2007/08 at least, another year of above average growth above is likely.

World Trade and Stocks, 2007/08

World Cotton Balance Sheet

(mil. bales)

	<u>2006/07</u>	<u>2007/08</u>
Beg. Stocks	54.3	52.9
Production	116.6	117.0
Imports	40.5	45.5
Total Supply	211.4	215.4
Consumption	121.3	125.0
Exports	40.0	45.0
Total Use	161.3	170.0
Residual	-2.9	-4.0
Ending Stocks	52.9	49.4

Continued rapid growth of consumption by China is projected to boost imports for both China and the world significantly, raising world imports 12 percent. China's consumption is forecast to exceed production by 24.0 million bales; with limited stocks to draw upon, the shortfall will have to be supplied by imports, currently projected at 20.5 million bales, or an increase of 32 percent from the 2006/07

forecast. USDA's China residual is raised to 4.0 million bales, partially offsetting projected import requirements.

China Cotton Balance Sheet
mil. bales

	<u>2006/07</u>	<u>2007/08</u>
Beg. Stocks	15.7	15.0
Production	30.9	31.0
Imports	<u>15.5</u>	<u>20.5</u>
Total Supply	<u>62.1</u>	<u>66.5</u>
Consumption	50.0	55.0
Exports	<u>0.1</u>	<u>0.0</u>
Total Use	<u>50.1</u>	<u>55.0</u>
Residual	-3.0	-4.0
Ending Stocks	15.0	15.5

With world exports expected to rise to a record 45.0 million bales, many of the world's cotton exporters will continue to reduce surplus stocks accumulated in the period 2003/04 to 2005/06. At 49.4 million bales, global stocks will be, in absolute terms, slightly below the 10-year average. However, the rapid growth in global consumption over the last several years means that the world stocks-to-use ratio will be the lowest level since 1994/95. For the world outside China, stocks-to-use will be the lowest since 2003/04.

U.S. Outlook for 2007/08

Area, Production, and Supply

U.S. planted area in 2007 will once again be influenced by a number of factors, including price prospects for cotton and alternative crops, weather during planting, and crop rotation benefits.

U.S. cotton prices are currently near year-ago levels, while competing crop prices have moved higher. The weighted upland cotton farm price has averaged 47.3 cents per pound during the first 5 months of 2006/07, similar to last season and below the national loan rate for upland cotton. As a result, market returns are being augmented by marketing loan benefits this season. As planting time for the 2007 crop approaches, cotton futures prices—as well as those for alternative crops like corn, sorghum, and soybeans—are above their respective loan rates, making the 2007 planting decisions likely based more on market return expectations than program benefits.

Last season, U.S. cotton planted area was 15.3 million acres—the highest in 5 years—and the general consensus within the industry is that cotton acreage will decline significantly in 2007, but the debate over how large a decline continues. At the end of March, USDA's National Agricultural Statistics Service will provide its first survey-based producer intentions of 2007 crop acreage. Meanwhile, the National Cotton Council published results in early February from its annual acreage survey that indicated cotton area in 2007 would decrease 13.5 percent to 13.2 million acres. Since this survey was conducted, prices for grains and soybeans have increased further, suggesting perhaps an even larger decline in cotton area for 2007. As a result, USDA is currently projecting that 2007 U.S. cotton acreage will range between 12.8 million and 13.2 million acres.

Attractive alternative crop prices—relative to upland cotton prices—are expected to pull acreage away from cotton in 2007. Harvest futures prices in mid-February for corn and soybeans had reached approximately \$4 per bushel and \$8 per bushel, respectively, well above year-ago levels. The growth in ethanol production is expected to pull at least 2 million acres away from cotton despite cotton's recent yield surge. As a result, USDA's initial 2007 cotton area projection of 13 million acres is the lowest in 17 years. Cotton plantings are likely to decrease most in the Delta region, with smaller adjustments occurring in the Southeast and Southwest. Total planted area in the West is not likely to change significantly, as some area shifts from upland to ELS cotton due to relative price prospects.

U.S. planted area is projected to fall 15 percent in 2007, and a smaller, more normal abandonment of about 9 percent is projected. The lower abandonment rate implies a projected harvested area of 11.8 million acres, only 7 percent below the current season's harvested estimate of 12.7 million acres. Assuming average growing conditions, the national yield in 2007 is forecast to decline from 2004-2006's three best yields on record to 815 pounds per harvested acre.

Based on these assumptions, U.S. cotton production in 2007 would total 20 million bales, with a range around the estimate between 19.5 and 20.5 million bales. At this level, 2007 U.S. cotton production would decrease considerably from the 23-million-bale average of the last 3 years. However, despite the potential decline in the cotton crop, U.S. cotton supply in 2007/08—including the current beginning stocks estimate of 8.3 million bales—would total 28.3 million bales, up from the current season and one of the largest of the past four decades.

U.S. Cotton Supply-Demand Estimates mil. bales

	<u>2006/07</u>	<u>2007/08</u>
Beg. Stocks	6.1	8.3
Production	21.7	20.0
Imports	0.0	0.0
Total Supply	<u>27.8</u>	<u>28.3</u>
Consumption	5.0	4.5
Exports	<u>14.5</u>	<u>18.0</u>
Total Use	<u>19.5</u>	<u>22.5</u>
Ending Stocks	8.3	5.8

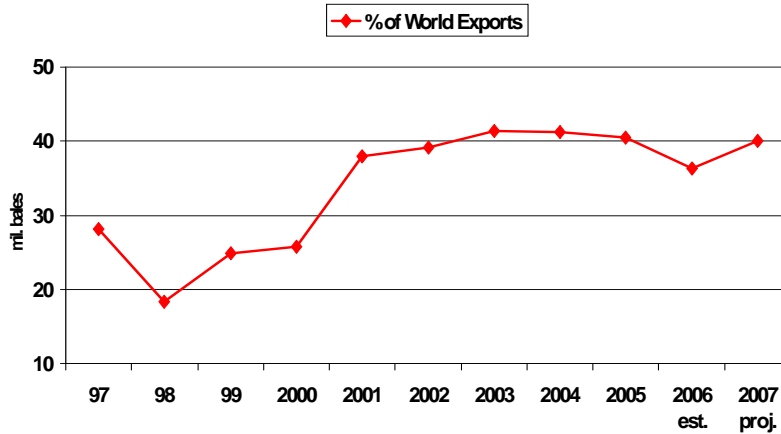
Mill Use and Exports

U.S. cotton domestic mill use is projected to fall 10 percent in 2007/08 to 4.5 million bales. Macroeconomic conditions are expected to be favorable, and U.S. consumers are likely to add at least 1.0 million bales of retail cotton use. However, cotton textile exports are anticipated to fall and textile imports will continue to challenge U.S. mills for market share. Cotton textile imports are estimated to have risen an average of nearly 1.2 million bale-equivalents for the 2005/06 and 2006/07 marketing years. Therefore, the increase in the projected textile trade deficit for 2007/08 would more than offset the probable increase in consumer use.

With a large U.S. exportable supply combined with anticipated strong foreign demand, USDA is projecting 18.0 million bales of U.S. exports for 2007/08. Due to its current restrictive import policies, China's 2007/08 beginning stocks are expected to be relatively tight, indicating a need for imports to sustain mills until the 2007 crop becomes available. Large U.S. beginning stocks will position the

United States to supply this demand and will likely provide a competitive advantage early in the season. The U.S. share of world trade is projected to return to its recent average of 40 percent.

U.S. Exports Share of World Trade



U.S. and Foreign Ending Stocks, 2007/08

USDA’s projections include a 7-percent reduction in world ending stocks to a level of 49.4 million bales and a stocks-to-use ratio of just under 40 percent, well below the 5-year average of about 46 percent. World stocks have declined over time partly because China, the world’s largest cotton consumer and importer, holds minimal stocks, relying on foreign suppliers to deliver cotton “just-in-time.” The U.S. is likely to draw down the large stocks cotton accumulated during 2006/07, finishing the season at a projected 5.8 million bales, with a stocks-to-use ratio of about 26 percent. Foreign countries other than China are projected to have the lowest stocks-to-use in five years.

U.S., China & Other Foreign Stocks through 2007/08

