USDA PERSPECTIVE ON THE OUTLOOK FOR COTTON

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The outlook for U.S. cotton continues to be a positive one as the twenty-first century approaches. Although budgetary pressures to reduce farm spending will remain a challenge, the efforts of the cotton industry to furnish new markets with U.S. cotton and cotton products continue to yield beneficial results for the entire industry. And with the new trade agreements in place, U.S. cotton will continue to play a vital role in the international market, as well as in the United States.

1994/95 Situation

U.S. Production and Consumption

U.S. cotton production is estimated at a record 19.7 million bales, well above the 16.1 million produced in 1993. Upland production is estimated at 19.4 million bales and extra-long staple (ELS) is projected at 342,000. Last August, the crop was expected to total 19.2 million, but improved weather conditions, primarily in the Southeastern and Delta States, increased yields and the crop size. The national average yield is forecast at 710 pounds per harvested acre, 4 pounds above the record set in 1987. The 1994 acreage abandonment rate, estimated near 3 percent, is less than half the previous 10-year average.

Production in the Southeast is estimated at 3.7 million bales, up 19 percent from the August estimate, and 89 percent above last year. Yields increased each month during the season, raising output to its largest since 1937. Georgia's production, at 1.6 million bales, is up 19 percent from August and equaling the State's largest crop. Similarly, North Carolina's crop is forecast at 820,000 bales, the largest since 1928.

The Delta States are expected to produce a record 6.9 million bales, 8 percent above the August estimate, and 48 percent above last season's crop. Yields in the Delta improved throughout the season and are estimated at a record 815 pounds per harvested acre. Arkansas is expected to produce 1.8 million bales, 61 percent above the 1993 crop and the largest since 1948. Cotton production in Louisiana is also up significantly at 1.5 million bales, the largest on record.

In contrast, estimates show upland yields and production lower this season in the Southwestern and Western States. For the Southwest, production is estimated at 5.2 million bales, with yields averaging 458 pounds per harvested acre. In the West, the crop is expected to total 3.6 million bales based on a yield of 1,179 pounds.

Yield and production forecasts were also lowered during the season for ELS cotton. Despite this, yields are expected to average 987 pounds per harvested acre, the second highest on record. However, 1994 ELS production is the smallest since 1988. The final USDA 1994 upland and ELS cotton production estimates will be released May 10.

Domestic mill consumption of cotton is projected to rise for the fourth consecutive season to its highest level since 1942. Mill use is forecast at 11.1 million bales this season, 6.5 percent above 1993/94. Data for the first 5 months of 1994/95 (August-December) indicate U.S. mills have consumed 4.64 million bales, compared with 4.24 million a year ago. On a seasonally adjusted annual rate basis, cotton consumption during August through December averaged 11.1 million bales.

Cotton mill consumption's strength is expected to continue as demand for U.S. cotton textile products remains robust both here and abroad. In support, cotton textile exports have risen for 10 consecutive years. During calendar year 1994, textile exports increased 15 percent above 1993 to surpass the one billion pound level, a new record. However, cotton textile imports have also reached new highs, expanding to nearly 3.8 billion pounds in 1994. Nevertheless, larger cotton textile exports continue to moderate increases in the textile trade deficit.

The solid demand for cotton can also be illustrated by its share of fiber use on the cotton system, which has increased each year since 1983. For the first 5 months of 1994/95, cotton's share has averaged nearly 77 percent, the highest since 1967. More impressive, however, is the fact that cotton's share has risen in an expanding fiber market, the result of the strong demand for denim, as well as for cotton apparel and home furnishings.

Foreign Production and Consumption

Outside the United States, production and consumption have been less robust. As the 1994/95 marketing year began, foreign beginning stocks had fallen 10 million bales in the preceding 2 years. Decreased crops in China accounted for most of this decline. Pakistan's crops fell during the same two years, but had a much smaller impact on stocks. However, a second year of shrinking supplies of Pakistani cotton played an important role in the large price increases that carried over into 1994/95.

With higher prices, foreign area rebounded in 1994/95, climbing 6 percent from its lowest point since the 1950's. China's area rose the most--11 percent or 550,000 hectares--and strong gains were registered in India, Brazil, and Argentina. In Uzbekistan, area fell for the seventh consecutive year despite the availability of higher world prices. And Australia's area fell following 3 years of drought that severely hampered irrigation.

While foreign area was higher in 1994/95, at 26.9 million hectares, it still remained below the levels reached during 1988-92. China's area remained 15-20 percent below the peaks seen during this period. Surging prices for other agricultural commodities and persistent pest problems decreased the attractiveness of producing cotton in China, as did a legacy of IOU payments to farmers. In the former Soviet Union, area fell 21 percent between 1988 and 1994 as decades of environmental damage took its toll, and changing priorities led Central Asian cotton producers to shift area to food crops.

Foreign production rose an estimated 3.5 million bales in 1994/95, due almost exclusively to area gains. Yields rose slightly as gains in China, Uzbekistan, and Turkey helped offset lower yields in Pakistan. Yields in India were unchanged as a more than adequate monsoon assured sufficient moisture in most areas, but hampered yields in other areas through flooding and pest development. As the season progressed, yield prospects in the Punjab were progressively lowered as a second year of pest damage unfolded in India's north. Similarly, earlier hopes for a rebound in Pakistan from the insect problems of a year earlier were dashed. Persistent September rains hampered spraying in Pakistan's Punjab, and insects and disease cut yields 5 percent.

Foreign consumption is expected to fall about 550,000 bales in 1994/95 to 73.9 million. Two years of falling consumption in China--the world's largest consumer--account for some of the decline. China's cotton consumption is expected to decrease slightly--based on sluggish yarn production early in the year--and with lower use, higher production, and higher imports, China's ending stocks are expected to rise in 1994/95. China is expected to import in the face of high world prices and growing domestic supplies to help fight inflation and meet regional stock-building needs.

Similarly, the fifth consecutive contraction expected in Russia's textile industry is also important. Declining cotton consumption in Russia and elsewhere in the FSU has been the major factor behind the falling and stagnant foreign cotton consumption since 1989/90. In 1994/95, FSU cotton consumption is forecast to have fallen 65 percent since 1989/90, to its lowest in at least 35 years.

World Trade

The failure of foreign production to sufficiently rebound in 1994/95 has had a significant impact on world trade. World cotton trade is projected at 28.6 million bales in 1994/95, up nearly 2 million bales from last season and the largest since 1990/91. In 1993/94, tight supplies had forced India and Pakistan to precipitously curtail exports and seek much larger than usual imports. With production in 1994/95 again below consumption, India and Pakistan are expected to import about 600,000 bales each, and cut their exports for the third consecutive year. With net imports for the two countries exceeding 1 million bales, India and Pakistan are expected to have their worst joint trade performance in cotton in at least 35 years.

China's increased imports have also had a significant impact on world trade in 1994/95. In 1993/94, China began its import purchases late in the season and, despite an expected higher crop in 1994/95, accelerated its buying through the first half of this year. With large imports reported through November, and even larger outstanding purchases, China's imports are expected to reach 3 million bales, below the 4.1 million imported in 1979, but the third highest ever.

Few exporters outside the United States are well positioned to take advantage of this increased demand for cotton. While the African Franc Zone is expected to boost its exports 870,000 bales, Australia's exports are expected to be hampered by a smaller crop, and Uzbekistan's by low stock levels and a smaller crop. The increasingly favorable trade prospects have been reflected in U.S. export sales this season. Export commitments continued rising in early 1995, growing over 500,000 bales and totaled 10.7 million bales by early February. U.S. exports are forecast at 9.6 million bales this season--2.7 million more than a year ago and the highest since 1926. Based on these estimates, the U.S. share of world trade is expected to exceed 33 percent, the highest since 1960.

Ending stocks are expected to rise outside of the United States in 1994/95, largely because of growing stocks in China. Excluding China, stocks are expected to tighten slightly, from 34 percent of consumption to 33 percent. Like China, Pakistan and India are expected to build stocks in part to help bring their domestic prices down.

1995/96 Outlook

U.S. Production, Consumption, and Trade

The U.S. outlook for 1995/96 points to much larger planted acreage as a result of the zero percent upland ARP and current price levels as planting time approaches. Total cotton acreage in 1995 could surpass 16 million acres, with a likely range of 15.7-16.2 million acres. This compares with an early-January survey conducted by the National Cotton Council (NCC) which indicated 1995 intentions of nearly 15.6 million acres. Although below the range mentioned above, the NCC survey provided producers' initial planting intentions but did not include those producers who may be planting their first cotton crop.

Although area could rise more than 2 million acres above this season, a return to more normal abandonment and yields may limit the potential of the 1995 crop. If the abandonment rate is near the 10-year average of about 7.5 percent, harvested area, based on the aforementioned planted acreage, would range between 14.5 and 15 million acres in 1995/96. While abandonment is expected to exceed this season's low 2.9 percent, yields are projected to decline from the record 710 pounds per harvested acre reached in 1994. Preliminary yield projections for 1995/96 range between 650-670 pounds per harvested acre, with the midpoint of this range, 660 pounds, equal to the 1990-94 crop year average.

In 1995, the U.S. cotton industry could witness back-to-back record crops. Based on the acreage and yield assumptions presented here, cotton production would likely range between 19.5 and 21 million bales in 1995/96. Coupled with the current beginning stock estimate of 2.7 million bales, total cotton supplies next season should range in the 22 to 24 million bale area.

Cotton mill consumption in 1995/96 is projected to extend its expansion as natural fiber products continue to dominate consumer purchases. As in 1994, cotton textile exports are also expected to play a vital role in the continued growth of U.S. cotton mill consumption.

Cotton textile exports reached a record in 1994, due in part to the positive effects of the North American Free Trade Agreement (NAFTA) which began in January 1994. Participation in agreements such as NAFTA should bode well for U.S. cotton textile products in the future, although textile imports are also expected to increase. Overall, improved demand for U.S. cotton products here and abroad could push U.S. cotton mill use to a new record. Current projections are for 1995/96 consumption to range between 11.2 and 11.7 million bales.

U.S. cotton exports, on the other hand, are expected to decline from the dramatic gains likely in the current season. Relatively low foreign stocks and the production problems in several of the major producing countries in 1994/95 led to the surge in U.S. cotton export commitments. In 1995/96, however, foreign production is expected to rebound somewhat. This would limit foreign import needs and possibly provide available exportable supplies to compete with U.S. cotton. More foreign competition translates into lower U.S. exports next season, perhaps as much as 2 million bales below the current season. Early projections for U.S. cotton shipments during the 1995/96 season range between 7.5 and 8.5 million bales. Although exports would be below the current season's level, the U.S. share of world trade would remain well above average, ranging between 27 and 31 percent.

Despite the anticipated decline in total demand for U.S. cotton next season, another record cotton crop may only boost stock levels modestly in 1995/96. Based on the scenario presented here, carryover stocks next season could increase to the 3 to 4 million bale level. However, with total use at or near record levels, this gain in carryover is meager at best, implying a stocks-to-use ratio of less than 20 percent and reflecting the need for another large U.S. cotton crop in 1996.

Foreign Production, Consumption, and Trade

In 1995/96, foreign production could total 65-75 million bales as area continues to grow and yields return closer to normal. Another year of rising prices is expected to boost area in most producing regions. China's announced target for cotton area is 6 million hectares, up 8 percent from 1994's planted area. In India and Pakistan, consecutive years of disappointing production and surging prices are expected to encourage additional production.

Foreign area of 28 to 29 million hectares is expected in 1995/96. Note that foreign area has surpassed 29 million hectares only twice before--1984/85 and 1991/92. Each time that occurred, China planted more than 6.5 million hectares and Central Asia exceeded 3 million. Since China and Central Asian producers seem to be setting their targets a total of about 800,000 hectares below these levels, a particularly strong price response elsewhere would be necessary if total foreign area is to exceed 29 million hectares.

Higher foreign yields are also likely in 1995/96, ranging from about unchanged at 520 kg/ha to 550 kg/ha. While it is reasonable to assume that yields outside China and Pakistan rise slightly to return to trend, prospects for China and Pakistan are unclear. China's yields are estimated to have improved in 1994/95, but remain below averages of the recent past. Whether this suggests one can assume a normal, higher yield in 1995/96 remains to be seen. Similarly, Pakistan's failure to deal with successive years of pest problems in one of its most crucial industries either suggests a greater likelihood of redoubled effort and success in

1995/96, or that Pakistan will be forced to endure such problems for years to come.

Foreign consumption in 1995/96 could range somewhere between 72 and 78 million bales. A continued improvement in the economic outlook in the foreign industrialized countries--particularly with respect to consumer spending--and a rebound in China's consumption provide much of the basis for anticipating an increase. In addition, real incomes in Russia are expected to rise in 1995, the first time since 1989. If the prolonged decline in Russian textile production ends in 1995/96, a significant drag on world consumption will be removed.

Prospects for imports are weaker in 1995/96, despite the improved consumption outlook in several importing countries. China's imports are likely to fall following 1994/95's stock build-up, and improved production would very likely cut imports by India and Pakistan.

Outlook to 2000

Farm Bill Issues

Policy discussions over the next several months will focus on enactment of the 1995 Farm Bill. Although several ideas concerning the new legislation, ranging from a continuation of the 1990 Act to its elimination, have been discussed, little in the way of specifics has been forthcoming. The Administration has yet to make a recommendation. However, on February 6, the President released his Budget proposal for FY 1996, which would be the first year of the new Farm Bill. A single paragraph in the USDA summary of that budget was the only hint of the Administration's thoughts on the Farm Bill.

> "The Budget does not include farm bill proposals for the commodity price and income support programs. However, reductions estimated at $1.5 billion in total over the 1998-2000 period are planned...Specific measures to achieve the targeted savings will be proposed at a later date."

In a press briefing, a USDA budget official reiterated that the specific means of cutting the farm support budget by $1.5 billion had not been worked out.

Meanwhile, on Capitol Hill, the chairman of the Senate Agriculture Committee has developed a list of questions on farm policy which imply that the very continuation of farm programs is at least open for debate. The chairman of the House Agriculture Committee appears to support the continuation of the programs, but will have to scale them back to meet budgetary requirements.

Although there is nothing definite yet as to specific policies that might be changed in the new Farm Bill, a case can be made that the cotton program should not be greatly altered. The program has worked, although the cost was high for a couple of years after the breakup of the Soviet Union. Central Asian cotton was placed on the world market at very low prices and program costs averaged over $1.8 billion per year in FY 1992 and FY 1993. Last year, program costs began to come down as U.S. mill use and exports rose. Mill use has risen 2.5

million bales since enactment of the 1990 Act, and the U.S. share of world cotton trade has climbed to well over 30 percent this year, averaging nearly 26 percent since 1991. The FY 1995 crop is projected to cost only about $350 million.

With cotton program costs declining and use of cotton increasing, some argue that things are headed in the right direction. However, if program cuts are needed to meet budget targets, there are certain program provisions that are likely candidates for change, either because budget reductions based on them would be easy to write and administer, or because they have been discussed at great length.

For example, many believe that an increase in the non-paid acres--the triple base acres--will be enacted as a budget saver. This would be easy to write, very understandable to observers and to farmers, and could be done either in the Farm Bill itself or the budget reconciliation process that will also have to occur during this session of Congress. The money to be saved from increasing the triple base is fairly easy to estimate, and the savings would be "real" savings. All of the money would come out of the farmers' pockets, however, because acreage on which deficiency payments could apply would be lower.

In addition, the Office of Management and Budget (OMB) has proposed for some time that anyone with off-farm income of over $100,000 should not be allowed to receive farm program benefits. OMB wants to "target" program benefits to producers who truly "need" them and who are primarily farming for a living. They believe this proposal will save money by keeping larger farmers out of the program, but there is not a good, defensible estimate as to how much might be saved. This idea would have a lot of public appeal, especially in a year when there is much debate in general about government benefits and who does or does not "deserve" them.

There has also been some discussion about the "Step 2 program" which makes competitiveness payments to domestic mills and to cotton exporters. Many suspect it will be eliminated in the 1995 Farm Bill. The savings from doing so are not readily estimated, however, since the provision contributes to the competitiveness of U.S. cotton. Without the provision, U.S. cotton would presumably be less competitive overseas and offtake may suffer. That decline would be made up by higher ARPs which could possibly lead to higher government costs in other areas such as deficiency payments.

Another item suggested for elimination is the 0/85 and 50/85 provisions for payment on under-planted acreage. This provision is little used by cotton farmers, who enroll only 200,000 to 300,000 acres in a given year. It has served as a stand-by disaster payment program, but the Crop Insurance Reform has reduced its attractiveness for that purpose since insurance indemnity payments must be foregone if payments are claimed for prevented planted acres. The Integrated Farm Management (IFM) provision of the 1990 Act employs 0/92-type payments as incentives for participation, and its environmental benefit might be lost if such payments were no longer available.

Much interest has also been expressed in providing farmers more planting flexibility than has been afforded them under current law. An expanded triple base would do that, but at some cost to producers. An alternative being discussed is the "Total Acre Base" (TAB) concept in which the farm's acreage base for program purposes would be the sum of all base acreage for the individual program crops now recorded on the farm under current law. Under the TAB approach, producers could plant any program crop or approved nonprogram crop on any or all acreage in the TAB. There would be no planting limitation except for the size of the TAB. Deficiency payments would "belong" to the original base acreage, however, loan benefits would continue to apply to the crop actually produced, not to the base acreage. The potential impact of this proposal on program costs may limit its appeal.

U.S. Outlook

The outlook for the U.S. cotton industry continues to look very positive over the next several years. The cotton sector, as a whole, is expected to gain partly as a result of the GATT agreement. While growth in domestic mill use and exports will be affected by the agreement, lower trade barriers are required with increased world trade anticipated over the next decade.

Growth in domestic mill use may slow as import quota restrictions are eased during the phase in period. Despite the potential for significant increases in textile imports, primarily apparel, larger U.S. textile exports of yarn, fabric, and semi-processed apparel items should continue to support domestic mill use. Cotton mill consumption is expected to rise 2 to 3 percent per year, surpassing 12.5 million bales by 2000/01. Although below the increases experienced during the previous 5 years, positive growth in mill use is anticipated.

On the other hand, export demand for U.S. cotton is expected to more than offset slowing mill consumption growth. Rising world incomes resulting from increased economic activity will be the driving force behind the growing demand for cotton textile products and raw cotton. With world trade growing between 1996/97 and 2000/01, U.S. cotton exports are projected to average near 7 million bales, as the U.S. share of world trade remains around 25 percent.

With larger total offtake as a result of lower trade barriers, U.S. cotton producers will likely be required to idle less acreage than otherwise anticipated. Despite a projected expansion of the cotton base by nearly a million acres over the next 5 years, relatively low upland cotton ARPs are projected to maintain the legislated stocks-to-use ratios. Cotton area is foreseen below the 1995 expectations, however, planted acreage between 1996/97 and 2000/01 is expected to average over 14 million acres annually.

The national average yield is projected to continue rising near the 25-year trend of approximately 10 pounds per year, reaching 720 pounds by 2000/01. With harvested area around 13 million acres during this period, production is expected to range between 18 and 20 million bales annually. As stocks are rebuilt and adequate supplies are available to meet the rising demand, the U.S. cotton industry will benefit as new opportunities to provide the global market with more cotton and cotton-containing products are presented.

Foreign Outlook

In the years leading out to 2000/01, foreign consumption is expected to grow much closer to its historical rate and by 2000/01, consumption should range between 84 and 88 million bales. Continued steady economic growth in the industrialized countries and robust growth in the developing world will play an important role in these gains. Also, the economic recovery seen recently in Eastern Europe is expected to spread to the FSU as the difficult transition to market economies progresses. With an improving economic environment, Russia's cotton consumption is forecast to grow during this period, though unlikely to reach its earlier highs.

China's rapid economic growth ensures steady cotton consumption gains there, while pressures from development, industrialization, and competition from other crops mean China's cotton production fails to keep pace. As a result, by 2000/01, China could become a regular large net importer. Southeast Asia is expected to steadily improve its level of cotton consumption and imports. Indonesia should rival Russia as the world's largest importer for much, if not all of this period. The traditional major importers of Japan, East Asia, and the EU are expected to continue losing cotton consumption and imports during this period, but not at the rapid rate seen since the late 1980s.

Like consumption, foreign production is expected to improve, reaching 74-80 million bales by 2000/01. Pakistan's yield growth is expected to resume during this period, although the rapid gains of the 1980's are unlikely to be repeated. Similarly, production in Africa's Franc Zone should continue rising, but at a slowing rate. Turkey is expected to resume net exports as the Southern Anatolian (GAP) irrigation project drives production steadily above consumption. However, most of this larger production will be consumed by Turkish mills. Brazil is expected to remain a net importer as current economic policies opening the economy to external influences remain in place, and cotton production remains well below earlier highs.

As the gap between foreign consumption and production narrows for a few years, the U.S. share of world trade may continue to decline before stabilizing around 25 percent. Gradually improving yields in Central Asia permit net exports by the FSU to rise for a time, although FSU consumption begins picking up closer to 2000/01. India and Pakistan are expected to return to net exporter status, with exports growing over the forecast period, and normal weather should permit Australia to increase its exports.

There are, of course, significant uncertainties surrounding these forecasts. Slower economic growth or unanticipated changes in consumer preferences could change the outlook for consumption. The reforming economies of the FSU and China are particularly difficult to forecast with respect to either consumption or production.

Similarly, the reforms of the world trading system under the recent GATT agreement add a further degree of uncertainty as the agricultural provisions affect competing crops and the textile provisions affect the location of cotton consumption. The relaxation of quotas under the Multi-fiber Arrangement (MFA) is assumed here to largely take effect after 2000/01, but the timing and degree of impact will depend on how the agreement is implemented by the member countries and the new World Trade Organization.

U.S. COTTON SUPPLY AND DEMAND

Item	1994/95	1995/96
	Million acres	
Planted	13.7	15.7 - 16.2
Harvested	13.3	14.5 - 15.0
	Pounds	
Yield/Harv. acre	710	650 - 670
	Million 480-lb. bales	
Beginning Stocks	3.5	2.7
Production	19.7	19.5 - 21.0
Total Supply	23.3	22.2 - 23.7
Domestic Use	11.1	11.2 - 11.7
Exports	9.6	7.5 - 8.5
Total Use	20.7	18.7 - 20.2
Ending Stocks	2.7	3.0 - 4.0

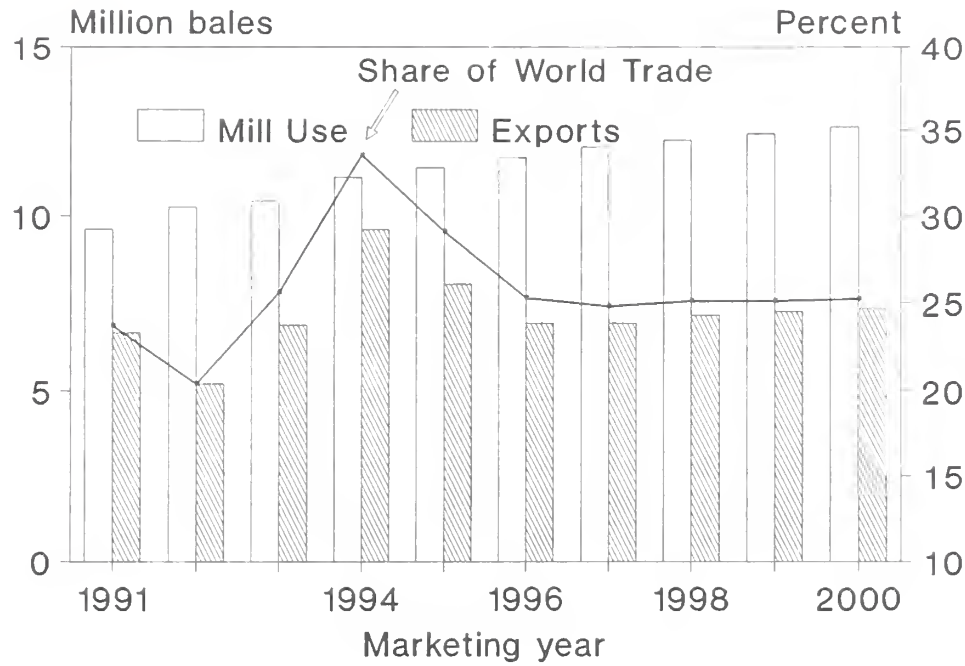
Based on February 1995 estimates.

FOREIGN COTTON SUPPLY AND DEMAND

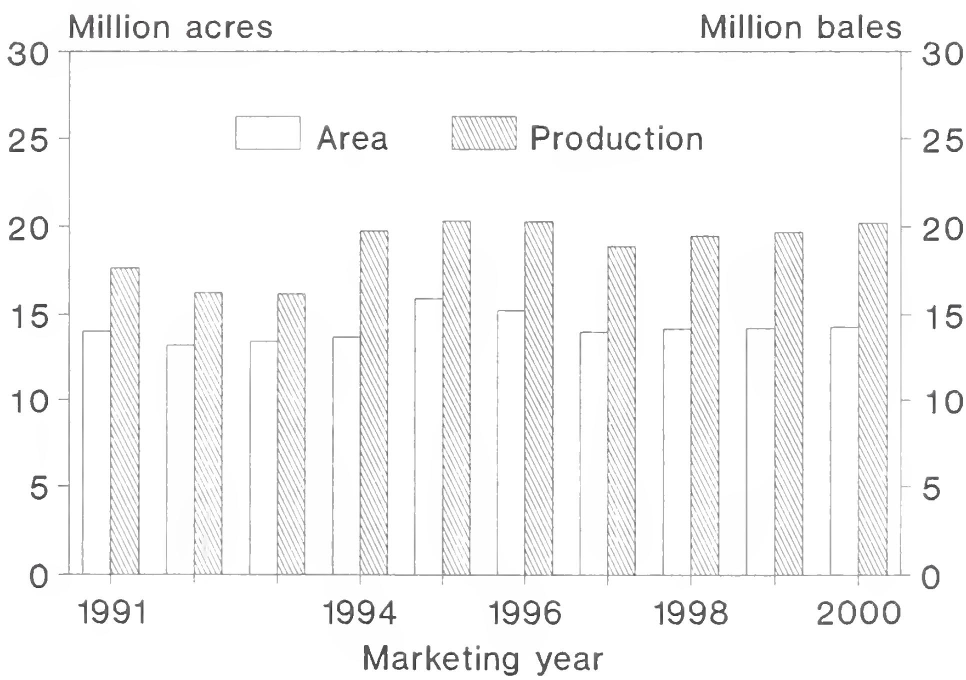
Item	1994/95	1995/96
	Million hectares	
Area	26.9	28 - 29
	Kilograms	
Yield/hectare	521	520 - 550
	Million 480-lb. bales	
Beginning Stocks	26.6	27.5
Production	64.3	65 - 75
Imports	29.8	26 - 30
Total Supply	120.7	118 - 132
Domestic Use	73.9	72 - 78
Exports	19.0	18 - 22
Total Use	92.9	90 -100
Ending Stocks	27.5	28 - 32

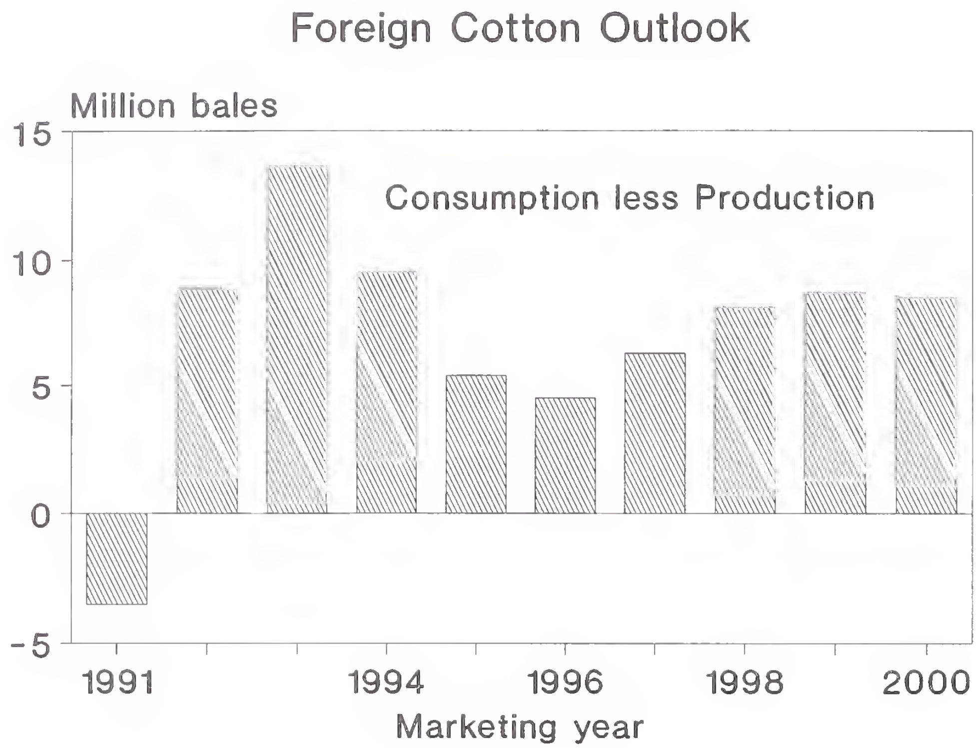
Based on February 1995 estimates.

U.S. Cotton Demand Outlook



U.S. Cotton Supply Outlook




Foreign Cotton Outlook
Million bales
15
10
5
0
-5
Consumption less Production
1991
1994
1996
1998
2000
Marketing year