Special Report

Cotton As A Possible Bellwether for Global Economies

Why International Cotton Markets Matter

Report by

Cotton Incorporated

Four years ago, fashion week shows were held online, retail stores became fulfillment centers, adults and school children stayed in pajamas and loungewear all day as many began remote work and schooling and there were more wild animals on city streets than shoppers. Things were decidedly not normal, thanks to the Covid-19 pandemic.

Of course, all of this affected the fashion industry from brands and retailers to textile manufacturers, mills and the farmers that produce natural fibers like cotton. Subsequent sourcing interruptions, inflation and concerns about recession were some of the pandemic's lasting effects. But now, experts say it seems we're "coming back to normal."

Cotton as Possible Bellwether for Global Economies

The industry headed toward the third official United Nations World Cotton Day on October 7, 2024 to acknowledge that "cotton is more than just a commodity. This natural fabric is a life-changing product worldwide that sustains 32 million growers (almost half of them women) and benefits over 100 million families across 80 countries in 5 continents."

In his Monthly Economic Letter, Cotton Incorporated's Jon Devine, senior economist in the corporate strategy and program metrics division, stated that after several months of decline, cotton prices stabilized in August 2024.

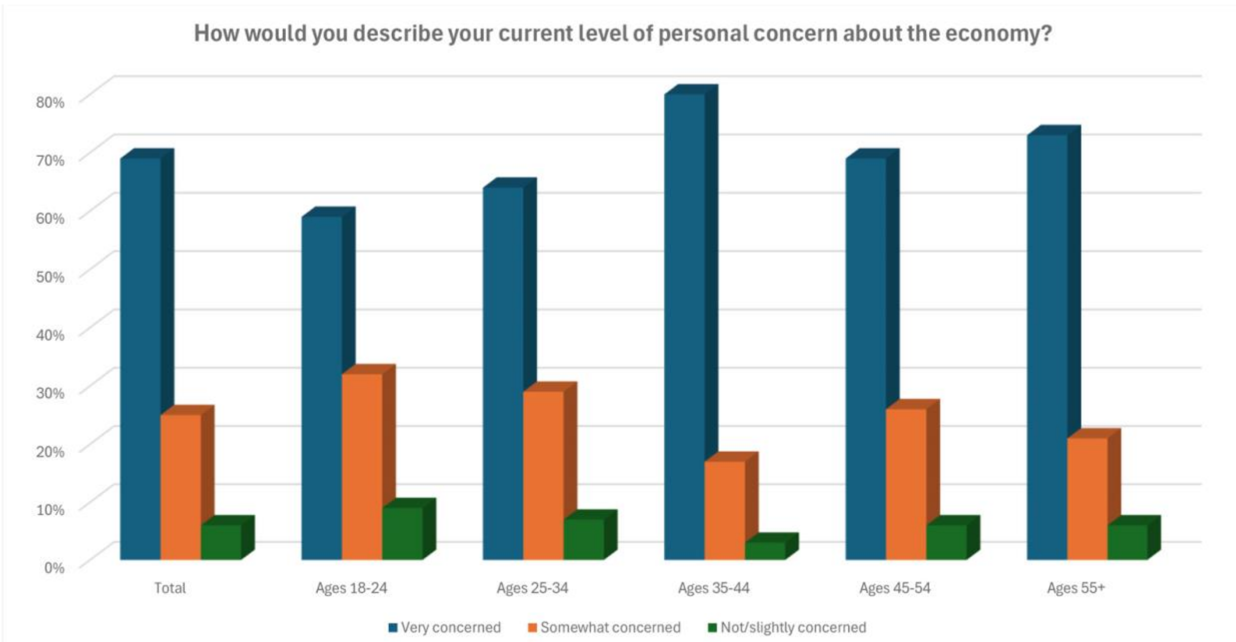
"Things have been tougher for U.S. growers because prices are down," Devine told the *Lifestyle Monitor™* in an interview. "Falling raw material prices have also been a problem for manufacturers because they effectively lose money on any supply they purchased when prices were higher. In addition, manufacturers have had to contend with volatile demand conditions. After widespread cancelations during Covid, there was over ordering after the release of stimulus and the period of stocking challenges with the shipping crisis. Then came the surge in inflation, recessionary fear with rising interest rates, and a collapse in order placement. The macroeconomic outlook remains cloudy but suggests stability may be coming with the expense of slower growth. That may still be a welcome tradeoff, given that it can allow for more ability to plan."

Sprint to End 2024

And retailers should still be planning for a solid fourth quarter, according to the National Retail Federation's Jack Kleinhenz, chief economist. "The momentum of the economy during the third quarter looked decent even though the labor market was showing some weakness," Kleinhenz told the *Monitor™* in an interview. "Consumers have remained resilient and have been driving the economy. Spending for the first 8 months of the year is very much in line with NRF's 2024 forecast of retail sales growth between 2.5 percent and 3.5 percent, which is great, although a bit of a slower pace than last year. The holiday shopping season is just around the corner, and we believe consumers will remain engaged for the holiday season."

Economy a Concern

Consumers remain unpredictable, though. For the last two years, the majority (68 percent) have said they are "very concerned" about the U.S. economy, according to Cotton Incorporated's Inflation and Supply Chain Survey (U.S. edition, Wave 8). Their top concerns focused on the prices of everyday goods like groceries and household items (58 percent), wages/salary keeping up with the cost of living (43 percent) and the cost of gas (32 percent).



These concerns, however, are not preventing them from spending. Shoppers were out in force during the 2024 Back-to-School shopping period. Consumers planned to spend an average of $472 on BTS clothes this year, up significantly from $378 in 2023, but down from $520 in 2022, according to Cotton Incorporated's 2024 Back-to-School Supplemental Survey. The higher spending in 2022 reflects Devine's assessment that consumers were making up for not spending during the pandemic when work-from-home and distance learning were widespread.

But for consumers planning to spend so much more this year than last, especially given their economic concerns, signals a bit of a difference between what they cite as a concern versus their actual spending.

"Yes, there is a disconnect between consumer attitudes and consumer spending," Kleinhenz says. "Consumer confidence survey data shows figures typically associated with a slowdown or in recessionary territory for some time. [But] American consumers like to spend and have had the capacity to spend despite higher prices."

Does Supply Meet Demand?

Overall, most U.S. shoppers agree that clothes shopping is a fun, social activity (64 percent), according to the Inflation and Supply Chain Survey. And most say they "feel hopeful for the future" (65 percent).

While the demand may exist, there is some concern on the supply side about production levels, and that's affecting the price of cotton. Devine says speculator positioning has been a driving factor for pricing changes that saw cotton vary from a brief high of more than $1 per pound in the early part of the year down to levels that have been below $0.70. A silver lining here though, is that it seems like the bottom for cotton prices has either been reached or should be close.

Cotton Economics

"Once you get the bottom in, that can help profitability throughout the supply chain," Devine says. "Somewhat counterintuitively, the worst thing for a spinning mill happens when prices drop -- because they've got orders out there for raw materials. In the time between the period when those materials were bought and when yarn is made and sold, yarn prices would have likely fallen alongside fiber prices. The implication is that spinners get pinched. They've been getting their knees cut out from underneath them like this for the past couple of years as cotton prices have moved lower. So, if we get to a situation where the bottom is in, this process will stop. As the market eventually comes up and off the bottom, that may help spinning mills in terms of their ability to make some money on a reversal of the conditions that have existed for the past couple years as cotton prices have fallen from their post-Covid high in 2022. And that may help get demand going, which can eventually help the grower."

For next year, growers probably won't plant as many acres of cotton here in the U.S. Devine says demand may move higher in that time period which will help to deplete excess cotton that exists, and that will set growers up for a better price situation moving forward.

Demand may also increase now that the Federal Reserve has lowered interest rates by 0.50 percentage points, the first reduction in four years. Additionally, J.P. Morgan strategists believe there will be two more rate cuts in 2024, with cuts continuing into 2025. Devine says that when the Fed started increasing interest rates in March of 2022, there was a pullback in demand. With the rate drop, headwinds for economic growth slow and that could help orders come through and increase demand through the supply chain.

Tariff Transitions

The market for cotton may also change with recent actions announced by the White House, where it's looking to enforce laws and address "significant increased abuse of the de minimis exemption, in particular China-founded ecommerce platforms, and strengthening efforts to target and block shipments that violate U.S. laws." Currently, import shipments are eligible for de minimis exemption if the package is valued at $800 or less. The shipments enter the U.S. with less information than other imports and are not subject to duties or taxes.

Direct-to-consumer retailers Temu and Shein have benefited greatly from the de minimis loophole. Both China-based companies rely heavily on cheap polyester materials. Changes to the de minimis rule could potentially stem the flow of low-price synthetic goods, and encourage consumers to look for better quality, more durable apparel that benefits U.S. brands.

Slower Growth Mode

As far as cotton production, the biggest year over year increase is expected to come from the U.S., which has seen an increase of about 2.5 million more bales than last year. But the increase only seems so big because in 2023, the U.S. market saw its smallest crop since the 1980s.

Overall, the U.S. market has seen a decrease in production that stems from issues with weather. "We get one shot at planting per year. Once seeds are in the ground, the weather takes over as the primary variable affecting output," Devine explains. "As has been the unfortunate case in recent years, things got hot and dry in West Texas this year, where there is little irrigation. That has been the most important weather-related issue, taking out millions of bales of production."

International Cotton Markets

- The U.S. cotton prices also contracted due to strong Brazilian production, which reached 14.6 million bales in the most recent crop year, a record for the country. Devine explains that as a tropical country, Brazil's agricultural environment is year-round. Over the past 10 years or so, farmers have planted two crops on the same land within the same year. For instance, they can plant soybeans, harvest them and then plant corn or cotton right after that, increasing production in their acreage without increasing their acreage. Everywhere else in the world, growers can usually only plant one crop. Since Brazil has so much to export, its prices dropped into the spring, which drove down prices on U.S. cotton.
- Globally, the U.S. Department of Agriculture expects 2024/25 will see an increase in global production (+3.1.2 million bales to 116.2 million) and world mill-use (+1.4 million to 115.2 million).

- In Pakistan, cotton production has seen a decrease of -300,000 bales to 5.7 million, but its spot prices increased from $0.76 to $0.81 cents per pound. Devine says several factors have come into play that have affected Pakistan's production. "Pakistan had issues with their cotton seeds," Devine explains. Seeds can have different traits, including the ability to protect the seed from pests. "They haven't had the best controls, so they have lost some of that protection over time. They need new seeds to come in. They've also had issues with flooding. And the financial situation as a whole isn't great in Pakistan. Also, the weather has been really hot to the point that at times this year, temperatures were about 120 degrees. So, they have had challenges on several fronts."
- India's spot prices increased from $0.86 to $0.90 per pound. India's production decreased by -500,000 bales to 24 million. The country also had issues with weather over the last few months and their crop numbers are getting smaller. However, India's minimum support price (MSP) guarantees to growers over the past several years. When prices were higher and above the guaranteed price, it wasn't a problem. But now that prices are lower, the Indian government will likely need to step in, as the MSPs are enforced by the government. This also means the government would take possession of the cotton and withhold it from the market. But unlike in China, where cotton can be stored for years, storage in India is usually for just a period of months. The cotton may come back on the market only to be sold at a loss.
- China remains the world's largest cotton producer. Its production increased +300,000 bales to 27.8 million. China also has a reserve stock that was brought in last year, making their market well supplied moving into the 2025 season. This means it's decreasing its imports by -500,000 bales to 9.5 million. That's a big difference from last year when the country replenished its stock with imports from countries that included the U.S., Brazil, Australia and West Africa. Another concern is that while Chinese consumers have represented a tremendous market for both apparel and textiles, the outlook for growth is sluggish right now. "As they came out of Covid, the collapse in the housing market is a huge issue for them," Devine says. "We've seen housing prices there decrease anywhere from 15 percent to maybe 20 percent, so that's a big impact on the household finance situation in China because an estimated 70 percent of Chinese wealth is in the housing market. And if household finances aren't looking good, they're going to be less likely to spend. We are seeing some stimulus come out in China, but nothing really in comparison to what was released in the U.S. and Western markets with Covid. We're probably not going to see the strength of consumer demand that we've seen in the past couple of decades."

But in the U.S., again the overall economic outlook is favorable, and the outlook for cotton pricing is seeming to head in a positive direction. “The bottom on pricing should be pretty close in terms of fiber prices,” Devine says. “And as we move on from there, we can get some profitability brought back into the market.”

Onto the Future

Devine states that, “After incessant volatility since the onset of the trade dispute and the spread of Covid-19, the outlook suggests a more stable macroeconomic environment. That stability may be coming at the expense of slower growth, but it should also enable a greater ability to plan.” If you use the cotton market as an overall economic bellwether, he adds, “Alongside a more stable business environment, the cotton market has calmed. This has been a product of additional supply coming onto the market, and that supply will take some time to work through. This suggests that raw cotton costs should remain attractive and stable, enabling more predictability around sourcing costs.”