Overview:

After declining by a sharp 12.4% in 2015-16, cotton production is projected to increase in 2016-17 by about 4% due to favourable weather conditions.

Cotton prices during the year are expected to remain stable or increase only marginally on back of higher supply and a decline in domestic consumption of cotton as well as weak demand from China.

Cotton yarn demand is expected to be weak due as demand for readymade garments and home textiles from US and EU are expected to recover only in 2017-18. Also, demand for direct yarn exports is expected to remain under pressure as demand from China is expected to decline.

Capacity addition is to slow down in the coming years.

Cotton production

In CS 2015-16, India surpassed China to become the largest producer of cotton. Acreage for cotton in the country is estimated at 11.9 million hectares in cotton season 2015-16. India has the highest acreage for cotton as compared with the other major cotton producing nations in the world. Cotton production was estimated to be 5.7 billion kg in domestic cotton season (October to September) 2015-16. In CS 2016-17, India’s production is estimated at 5.9 billion kg, higher by about 4% on a y-o-y basis due good rainfall and satisfactory sowing of the crop despite reduction in acreage.
Cotton Prices

**World** – World cotton production is projected to be lower than its consumption for the second year in row. This will support the cotton prices in CS 2016-17. However, due to the auction of its cotton reserves, demand from China (world’s largest consumer), will be lower which would counter the higher price movements.

In December 2016, global cotton prices remained stable on m-o-m basis at ~79.5 US cents per pound due to stable supply and weak demand. Also, low demand from China has increased the availability of the fibre globally putting downward pressure on the prices.

**Chart 2: Cotlook A Index (World Cotton Season Starting August 1)**

Source: Cotton Outlook

**Domestic** - Domestic cotton prices fell by about 16 per cent during July-November 2016 on back of weak demand from the spinners. However, in October-December 2016, prices picked up marginally with the new cotton arrivals in the market. This is so because typically new crop prices are always higher despite supply increase in the market for a
month or so. Subsequently it increases further or drops depending on the daily arrivals and demand from spinners. When arrivals increase in the market, prices fall subsequently and spinners purchase in bulk (3-4 months inventory) which leads to subdued demand in following months. Purchasing is completed by March or latest by Apr-May. In November-December 2016, daily cotton arrivals were lower by ~10 per cent y-o-y due to demonetisation and hence prices increased. In CS 2016-17, with increase in production and stable consumption, cotton exports are expected to pick up.

In December 2016, prices of cotton (S-6 variety) increased to Rs 110 per kg on back of restricted arrivals due to cash crunch and CCI’s intervention to purchase cotton at market price from various parts of the country. As per CCI, cotton arrival till December 2016 reached 1.3 billion kg which is 10 per cent lower on a y-o-y basis. However, despite a marginal rise in prices in Q3 2016-17, prices are expected to stabilize in H1 2017 on back of increased supply post demonetization effect.

Chart 3: Domestic Cotton Prices (Domestic Cotton Season starting October 1)

Domestic cotton prices increased by about 8% in 2013-14 as demand from China remained strong along with other countries. In 2014-15, while the production remained high, demand from China went down thereby dropping the price by a sharp 20% y-o-y. In 2015-2016, prices remained largely stable on back of stable demand-supply scenario. In Q1 CS 2016-17, prices of Shankar-6 increased by about 20% y-o-y. However, despite the surge in prices, it is expected to stabilize or increase only marginally in H1 2017 on back of surplus production and weak demand from China.
Cotton Yarn Production

After declining by 10 per cent in 2011-12 cotton yarn production increased by over 14 percent y-o-y to 3,583 million kgs in 2012-13. In 2013-14, production increased by about 10 per cent to 3,928 million kgs. High cotton prices and easy availability of MMF (manmade fibres) at competitive rates led to slower growth of production of cotton yarn. CY production grew by marginal 3-3.5 per cent in 2014-15 and 2015-16. As per Office of Textile Commissioner, cotton yarn production was 4,138 million kgs in 2015-16.

In 2016-17, cotton yarn production is estimated to fall by about 5-7 per cent to 3,936 million kgs on back of sluggish derived (Domestic yarn demand) demand with substitution taking place from MMF as well as distressed direct yarn exports due to lower demand from China. Yarn demand in other export markets will be healthy. However, on a y-o-y basis demand will be lower.

Chart 4: Cotton Yarn Production and Prices

Source: Office of Textile Commissioner, CMIE

Cotton Yarn Demand

Demand - Cotton yarn demand in India grew at a healthy pace in 2015-16, supported by domestic demand and yarn exports. In 2016-17, demand is expected to be sluggish as derived demand and direct yarn exports will be under pressure. Also, with alternatives being explored for crude oil such as shale, prices of crude oil are largely expected to be stable during the year. Hence, demand for cotton yarn will face stiff competition from its easily available substitute – manmade fibres (synthetic yarns).
In December 2016, cotton yarn prices (40’s count) remained stable at Rs 217/kg due to weak domestic demand on account of the demonetisation drive. However, export demand of cotton yarn has been improving and prices have remained stable.

Components of demand - Steady domestic offtake owing to an improvement in economy will push the overall yarn demand in the long run. Derived demand is expected to be under pressure in the near term but will pick up eventually, as demand for readymade garments and home textiles from US and EU are expected to recover in FY 2018. Direct yarn exports could be under pressure in near future. However, in medium to long term decrease in demand from China will be offset by improvement in demand from Bangladesh, Pakistan and Vietnam.

Cotton Yarn Prices & Profitability

Cotton yarn prices are expected to recover in the near term, after witnessing a decline in 2016-17 owing to a fall in derived demand and lower cotton prices. However, operating margins of spinners will remain under pressure in the medium term as the increase in cotton yarn prices will be lower than the increase in cotton prices on back of oversupply and subdued demand in the industry. Also, due to expected fall in the demand for cotton yarn, the utilization rates of the domestic spinners is expected to be lower which will put further pressure on the margins.

Cotton yarn prices are highly volatile due to volatility in the demand (depending on price of the substitute – synthetic yarn), which is majorly impacted by exports of cotton and cotton yarn. India exports around 15-20% of cotton and 30-40% of cotton yarn. Therefore, even a minute change in the exports demand supply scenario will significantly impact domestic prices and thereby the margins of the yarn spinners.

Capacities & Investment

There are 1,980 spinning mills under Non-SSI and 1,350 spinning mills under SSI in India. India’s spindle capacity reached 50 million in March 31, 2015. There were low capacity additions during the period from FY 2010–11 to FY 2014–15 due to volatile demand and prices of cotton and cotton yarn, due to which profitability of yarn spinners was under pressure. High inventories and relatively lower prices of man-made fibres during FY 2010–11 to FY 2014–15 resulted in subdued demand for cotton yarn.

Capacity addition will slow down as the industry will be adding only around 3 million new spindles between FY2016 and FY2021 due to overcapacity, subdued demand and lower central government benefits due to changes in the Technology Upgradation Fund Scheme (TUFS). Majority of new capacity is expected to be added in Maharashtra, Gujarat and Telangana.
Conclusions:

- **Cotton prices are expected to remain largely stable or increase only marginally on y-o-y in CS 2016-17**
- **Cotton yarn demand is projected to be lower on back of weak demand from China which is the world’s largest consumer. However, in medium to long term decrease in demand from China will be offset by improvement in demand from Bangladesh, Pakistan and Vietnam.**
- **However, cotton yarn demand will be closely monitored due to China’s cotton policy as well as stable crude oil prices leading to stiff competition from its substitute – manmade fibres (synthetic yarns).**