

Cotton & Cotton Yarn Update – Review CS 2017-18 & Outlook CS 2018-19

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Overview

After increasing by about 2% in cotton season (CS) 2016-17, India's cotton production is likely to witness a higher growth rate of over 8% in CS 2017-18 with production increasing to 6.4 billion kgs during the year on back of increased acreage under cotton with favourable weather conditions. Area under cotton cultivation increased by about 12.8% during CS 2017-18 to 12.3 million hectares.

Cotton prices during the year remained largely stable or increased only marginally on back of higher supply in the market. Going forward, in CS 2018-19, domestic consumption of cotton is expected to marginally improve on back of improvement in exports demand, mainly from China along with higher MMF (man-made fibres) cost due to increasing crude oil prices

In CS 2018-19, CARE Ratings expects cotton prices to marginally pick up from the current levels and remain firm with the new cotton arrivals in the market on back of improved global demand - exports and increased MSP by the government. ***With limited supply in the market during H1 CS 2018-19 on account of increased orders from China, prices are expected to register a growth of about 5-7% and reach Rs 122 - 125 per kg during this period and average at about Rs 127 - 130 per kg for CS 2018-19 registering a y-o-y growth of about 9-11%.***

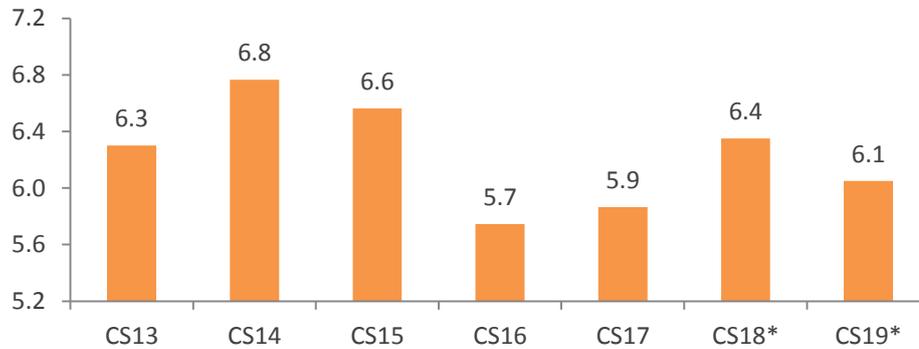
Cotton yarn production in India continued to remain sluggish during the 2017-18 registering only a marginal growth of about 0.1% y-o-y after declining by about 2% during the same period last year. Subdued export demand along with high cotton prices and availability of MMF (manmade fibres) led to slower growth of production of cotton yarn. Also, with the goods and services tax (GST) implementation in July 2017, the overall textiles industry faced slowdown. ***Going forward, in 2018-19, with high cotton prices and sluggish domestic and export demand for cotton yarn, the yarn production is expected to stagnate at the current levels.***

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Cotton production

In CS 2017-18, India’s production stood at 6.4 billion kg, higher by about 8.3% on a y-o-y basis due to near normal rainfall in most parts of the country and satisfactory sowing of the crop with increase in acreage under cotton. In CS 2017-18, the acreage under cotton increased by about 12.5% to 12.3 million hectares.

Chart 1: Cotton production (Billion kgs)



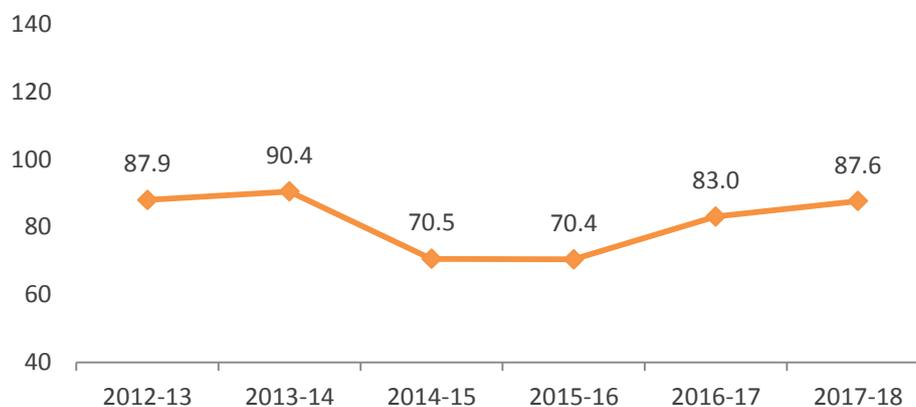
Note: * Estimated, CS – Cotton Season (International cotton season starts August 1)
Source: International Cotton Advisory Committee (ICAC)

Cotton Prices

World – World cotton production is projected to be lower than its consumption for the third year in row. This y supported the cotton prices in CS 2017-18 despite the subdued demand. However, due to the auction of its cotton reserves, demand from China (world’s largest consumer) remained lower and countered the higher price movements. Also, bumper crop in India, China and USA kept the prices largely range bound with limited room for increase.

During CS 2017-18, global cotton prices increased only by about 5.5% y-o-y to 87.6 US cents per pound after increasing by about 18% y-o-y during CS 2016-17 on account of increased world supply and subdued demand during the year. Also, low demand from China has increased the availability of the fibre globally putting downward pressure on the prices. China held the state auction of their reserves and sold over 2 million tonnes leading to a decline in their supplies while stocks outside China are expected to moderately increase in the upcoming CS 2018-19.

**Chart 2: Cotlook A Index (US cents/pounds)
(World Cotton Season Starting August 1)**

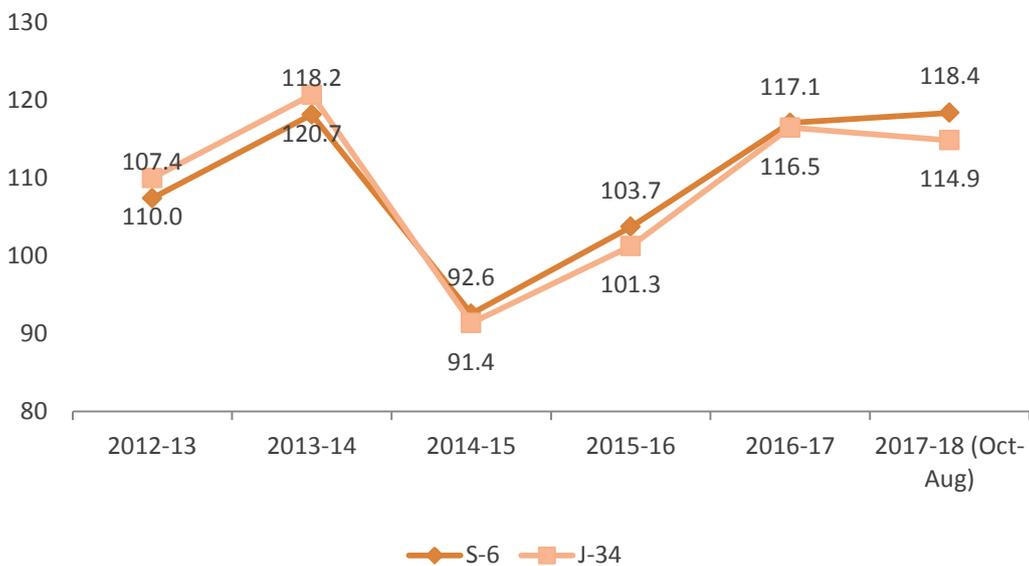


Source: Cotton Outlook

Domestic - Domestic cotton prices remained range bound during cotton season (October-September) 2017-18 at about Rs 117 per kg on account of subdued demand from the spinners. However, in the last few months (Jun-Aug 2018) domestic prices have witnessed an upward trend by registering a growth of about 7-9% y-o-y. This temporary increase can be attributed to the pink bollworm attack that created concerns about supplies among farmers in Maharashtra and Telangana and traders along with increased imports from China that doubled its import quota and its tariffs on the US crop in June 2018. Also, the government announced increased MSP for cotton for FY19. Demand from China is expected to improve further on back of falling stockpiles in the country while the production is expected to take a hit on account of frequent hailstorms followed by continuous rains in major cotton producing regions. **Going forward, we expect prices to marginally pick up from the current levels and remain firm with the new cotton arrivals in the market on back of strong exports and increased MSP by the government.** According to the Cotton Association of India (CAI) China will be importing around 2 million bales of cotton from India during the first quarter of the new cotton season 2018-19. This is expected to keep the supply in the domestic market tight. **Prices are therefore expected to register a growth of about 5-7% and reach Rs 122 - 125 per kg during this period and average at about Rs 130 per kg for CS 2018-19.**

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.

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

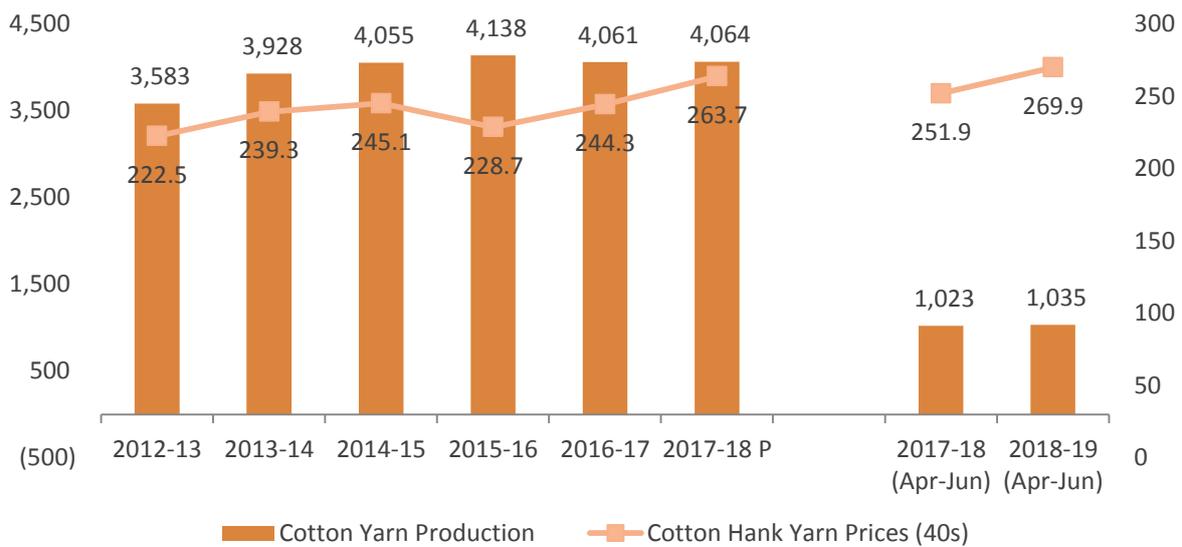


Source: CMIE

Cotton Yarn Production

Cotton yarn production in India continued to remain sluggish during the 2017-18 registering only a marginal growth of about 0.1% y-o-y after declining by about 2% during the same period last year. Cotton yarn production stood at 4,064 million kgs during 2017-18. Overall demand for cotton remained low during the year on account of weak exports demand coupled with high cotton prices. Also, derived demand (domestic yarn demand) continues to be sluggish and with substitution taking place from MMF as well as distressed direct yarn exports due to lower demand from China.

Chart 4: Cotton Yarn Production (Million kgs) and Prices (Rs/kg)



Source: Office of Textile Commissioner, CMIE

Cotton Yarn Demand & Price

Demand: Cotton yarn demand in India continued to remain sluggish during the 2017-18 registering only a marginal growth of about 0.1% y-o-y after declining by about 2% during the same period last year. Subdued export demand along with high cotton prices and availability of MMF (manmade fibres) led to slower growth of production of cotton yarn. Also, with the goods and services tax (GST) implementation in July 2017, the overall textiles industry faced slowdown. **Going forward, in 2018-19, with high cotton prices and sluggish domestic and export demand for cotton yarn, the yarn production is expected to stagnate at the current levels.** With the industry now stabilising post demonetisation and the implementation of the goods and service tax (GST) regime, the demand from downstream industry - apparels and made-ups, has only marginally picked up in the last few months. *In terms of exports, with lower demand from major importing country China, cotton yarn exports are likely to continue to remain under pressure going forward.* China has been increasingly importing cotton yarn from Vietnam instead of India since last few years as exports from India attract a 3.5% duty while Vietnam has duty-free access to Chinese markets. Also, Chinese yarn manufacturers have set up their operations in Vietnam for free flowing trade activities.

Apparel exports to the US witnessed growth of about 5.5% y-o-y during March 2018 to US \$1.4 billion during April - July 2018. Garment manufacturers are now replenishing stocks post using up old inventory during implementation of GST. **Cotton prices witnessed sharp increase during June-July 2018 and are expected to remain firm for the remaining months of the year.** Going forward, with the sanctions by US on Iran coming to play, the crude oil prices are expected to further see

an increase, thereby increasing the substitute manmade fibres (MMF) prices. **Hence, Care Ratings expects the demand for cotton yarn to improve during the upcoming season.**

In FY18, cotton yarn prices (40's count) increased by about 8% y-o-y to Rs 264 per kg despite weak domestic demand on account of the high cotton prices. Similarly, during Q1 FY19, cotton yarn prices continued to increase by about 7% to Rs 270 per kg on back of higher input cotton cost. Also, export demand for cotton yarn has been improving and prices are expected to move in line with the cotton prices.

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 2018. Direct yarn exports could continue to be under pressure in short term. 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 have started recovering in the near term, after witnessing a decline in 2015-16 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. Also, any fluctuation in crude oil impacts the prices of the substitute man-made fibres and 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

Currently, there are 1,804 spinning mills and 205 composite mills under Non-SSI and 1,353 spinning mills under SSI in India. India's spindle capacity crossed 50 million in March 2015. However, industry currently stands at over 47 million spindles along with 0.6 million rotors and 53,000 looms as of July 2018. Low capacity additions due to volatile demand and prices of cotton and cotton yarn are expected to keep the profitability of yarn spinners under pressure. Capacity addition has slowed down as the industry as many players have stalled their expansion plans till 2021 due to existing overcapacity in the industry, sluggish demand for fabrics and apparels and lower central government benefits due to changes in the Technology Upgradation Fund Scheme (TUFS).

Conclusions:

- With the industry now stabilizing post the demonetization and the implementation of the goods and service tax (GST) regime, the demand from downstream industry - apparels and made-ups from both domestic and international markets, has only marginally picked up in the last few months.
- In CS 2018-19, we expect cotton prices to marginally pick up from the current levels and remain firm with the new cotton arrivals in the market on back of strong export demand and increased MSP by the government. ***With limited supply in the market during H1 CS 2018-19 on account of increased orders from China, prices are expected to register a growth of about 5-7% and reach Rs 122 - 125 per kg during this period and average at about Rs 127 - 130 per kg for CS 2018-19 registering a y-o-y growth of about 9-11%.***
- Also with high cotton prices and sluggish domestic and export demand for cotton yarn, the cotton yarn demand is expected to stagnate at the current levels majorly on account of weak demand from China which is 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 and diminishing stockpiles as well as high crude oil prices that impact the prices of its substitute – manmade fibres (synthetic yarns).