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Brazil

Cotton and Products Update

Strong Prices, Export Demand Drive Sector Growth

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Report Highlights:
Post forecasts Brazil's 2018/19 marketing year (MY) cotton area to reach 1.4 million hectares (ha), an increase of 19 percent compared to the previous MY. The planted area expansion is a result of rising cotton prices and strong export demand. Exports are forecast to reach 6 million bales, up from 4.2 million bales from the banner 2017/18 season. Domestic consumption is forecast at 3.5 million bales, which is a marginal 3 percent increase compared to last MY, due to Brazil's uncertain economic outlook for the next year.

PRODUCTION

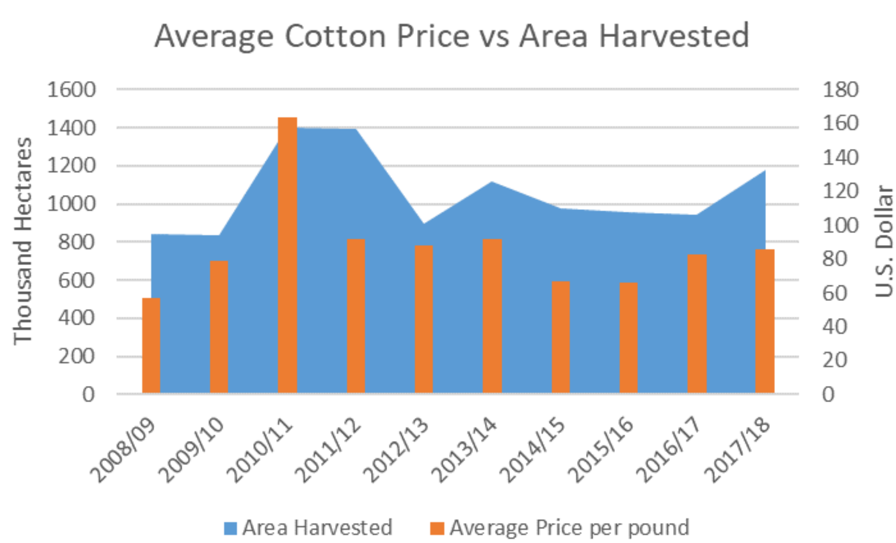
The Post forecast for planted area in the 2018/19 marketing year (MY) is 1.4 million hectares (ha), an increase of 19 percent over the 2017/18 USDA estimate. Cotton prices, in particular FOB export prices, are the main factor behind producers' decision to accelerate expansion of cotton planted area. The yield is forecast to remain just above 1700 kilograms per hectare (kg/ha). As such, total production is expected to increase by 19 percent, to 11 million bales, equivalent of 2.4 million metric tons (MMT).

High Prices to Accelerate Area Expansion in 2018/19

According to Post's recent conversations with industry, cotton sowing area in Brazil is rigorously planned at least one, and even two years out, based on projected demand, and to an extent on forward sales. For example, according to Brazilian government statistics, in Mato Grosso state, almost 70 percent on 2018/19 cotton crop is already under contract despite the fact that most of cotton planting will not begin until January 2019. Other contacts indicate that informal purchase agreements are already forming the foundation for 2019/20 planted area expectations.

In addition to expectation of future demand, producers rely on returns from each harvest to reinvest in the coming season. The production cost for cotton per hectare in Mato Grosso is about three times that of soybeans. Due to such high upfront investment, without good returns that are heavily based on export performance, many producers simply do not have the means to invest as much in the following season crop.

With the successful 2017/18 cotton Marketing Year (MY) on the books, and a continued rise in global cotton prices, at least some producers are expected to accelerate their plans to expand cotton planted area. For example, according to a conversation Post had with producers in Mato Grosso, in 2018/19 many plan to as much as double their cotton planted area. Across the board, contacts have indicated that expansion in area has been in the works, though the recent price trend has accelerated the process. Other producers have indicated to Post that given the current price environment and high investment costs, they will devote a portion of area traditionally allocated for summer crop soybeans to cotton in order to maximize returns on expensive cotton ginning machinery.



* Cotton prices are for grade 41-4, staple 30/32mm, 8-day term payment, no interstate commerce tax. Includes freight for point of delivery Sao Paulo city
Source: Prices - Center for Advanced Studies in Applied Economics (CEPEA); Area Harvested – USDA

Mato Grosso & Bahia

Roughly two-thirds of Brazil's cotton production is concentrated in the cerrado plains of Mato Grosso state. The climate in Mato Grosso allows for two planting seasons. Typically, producers plant soybeans as a summer crop from mid-September to mid-December, and then the second – or safrinha – crop of either corn or cotton sometime in January to mid-March. On average about 85 percent of the cotton planted in Mato Grosso is safrinha.

The 2018/19 soybean planting got off to a roaring start in Mato Grosso, aided by very favorable weather patterns. By mid-November, producers had planted 96 percent of planned soybean area – a record fast pace for the state. Summer crop planting directly impacts the timeframe for the safrinha cycle. As a result, Post expects that in the 2018/19 season, producers will be able to plant safrinha cotton within the ideal planting window between January 10 to January 30, before the heat sets in.

There is some chance of a downward revision for planted area in Mato Grosso, because planting will not happen until 2019. For example, should weather predictions point to higher potential for abundant rainfall during harvest, producers may elect to plant slightly more corn, which is much cheaper to sow. Nevertheless, given current price levels, and continued expectation of strong export demand, revisions on the downside are unlikely.

Bahia state is the second largest cotton producer in Brazil, accounting for about a fifth of total production. Owing to a different climate, producers in Bahia plant just one crop per year. Cotton sowing in Bahia begins on November 20, following a mandatory sanitation period, which is a pest prevention measure. As elsewhere in the country, Post expects area expansion on the order of 15 to 20 percent in Bahia amid expectations of high prices and taking into consideration good returns from the 2017/18 season. This year, there is a higher risk of yields in Bahia being negatively affected by El Nino weather that may bring higher than normal rainfall during harvest time.

Table 1. CONAB* Cotton Estimate and Forecast by State

State	**2017/2018**			**2018/2019****		
	Area (HA)	**Yield**	**Production**	**Area (HA)**	**Yield**	**Production**
Mato Grosso	777,800	1659	1,290,200	875,100	1663	1,455,400
Bahia	263,700	1890	498,400	310,100	1588	492,500
Goais	33,000	1615	53,300	40,600	1608	65,300
Mato Grosso do Sul	30,400	1845	56,100	30,900	1845	56,900
Others	69,800		107,800	86,600		132,400
Brazil	**1,174,700**	**1708**	**2,005,800**	**1,343,200**	**1639**	**2,202,400**

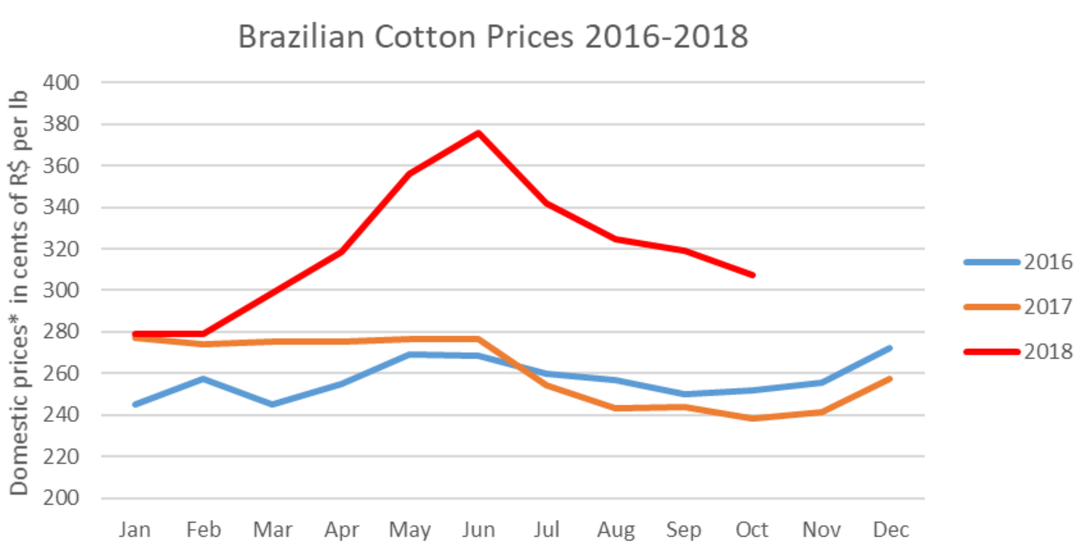
Source: CONAB 2º Levantamento - Safra 2018/19.
*Please note the numbers above are Brazilian government statistics, and as such do not match the Post forecasts.
**The 2018/19 forecast is for midrange.

Bumper Crop in 2017/18 Signals Domestic Recovery
The 2017/18 MY finished strong with estimated planted area of 1.17 million ha, which is an increase of 25 percent compared to the previous season. The increase was due in part to rising prices. In addition, the 2017/18 season was a recovery season from 2015/16 and 2016/17 when weak domestic economy acted as a drag on the sector. Cotton is cost intensive to produce, and with weak economic performance producers had difficulty accessing credit lines, and had sticker shock from high interest rates. Production for 2017/18 is estimated to clock in around 9.2 million bales (or 2 MMT), with yields at 1708 kg/ha.

Mato Grosso finished harvest in September, with total area of almost 780 thousand ha. Meanwhile, producers in the state of Bahia planted just over 260 thousand ha. These two states combine for almost 90 percent of Brazil's cotton production – 1.8 MMT of the total 2 MMT. Yields were particularly strong this season, aided by favorable weather.

PRICES

According to the University of Sao Paulo's Superior Agricultural School Research Center (CEPEA/ESALQ), domestic cotton prices in Reals saw a sharp increase in the year to date, registering a 22 percent increase by the end of October. In fact, nominal prices in 2018 have been some of the highest on record, eclipsed only by 2011 prices when cotton prices climbed above R$4 per pound (lb), representing the 41-4 type, delivered to Sao Paulo.



Source: Center for Advanced Studies in Applied Economics (CEPEA)
* Cotton grade 41-4, staple 30/32mm, 8-day term payment, no interstate commerce tax. Includes freight for point of delivery Sao Paulo city.

However, prices in U.S. dollars were only up about 7 percent on the year in the same timeframe. Therefore, while cotton prices did register the effect of stronger export demand, the rise was not as dramatic when factoring in the exchange rate.

In general, Brazilian cotton prices are heavily dependent on the exchange rate, which saw wild swings in the second and third quarter of 2018. The Real had decreased in value versus the dollar by about 25 percent in the run up to the Presidential election in September, only to swing by 13 percent in the other direction immediately in the aftermath of a stronger-than-expected performance by the center-right presidential candidate Jair Bolsonaro. The exchange rate has steadied since Bolsonaro prevailed in the second round run-off on October 28, which has provided a stabilizing force for cotton prices as well.

TRADE

Post forecasts cotton exports for the MY 2018/19 to increase to 6 million bales (1.3 MMT), up 44 percent on the 2017/18 season. The export forecast is based on an excellent harvest in 2017/18, which is mostly shipped in the following marketing year. The Post forecast also accounts for stronger export demand and the corresponding forward sales that are already in place. As mentioned in the production section of this report, in Mato Grosso, more than two thirds of the 2018/19 crop is already under contract.

The Brazilian Cotton Producers Association (ABRAPA) expects that in 2018/19 export demand for Brazilian cotton will remain very strong. ABRAPA maintains an office in Beijing, and its representatives regularly travel to meet with the main buyers of Brazilian cotton overseas. The organization expects increased interest in Brazilian cotton from buyers in China as well as from Chinese-owned textile mills in other Asian countries, stemming in part from the U.S.-China trade tensions, and in part from the reported continued improvement in grading and quality of Brazilian product.

In recent years, ABRAPA invested heavily in improving the image of Brazilian cotton to support higher international demand. This year, ABRAPA launched the Standard Brazil High Volume Inspection (HVI) Program, which aims to standardize cotton's instrumental classification, and computerize access to classification data. The program uses its new national reference lab in Brasilia to verify HVI test results in the 14 different labs around the country. The lab uses the latest technologies and is currently being prepared to obtain the ICA-Bremen certification, which is an international laboratory certification and is a world-class standard in cotton classification.

ABRAPA aims to secure the ICA-Bremen recognition before the end of next year. Once in place, the goal is that international recognition of Brazil's HVI program should assure buyers of product quality and corresponding price, and mitigate any associated existing risk premium built into price and volume purchasing decisions.

Post forecasts that imports will remain at about the same level of 80 thousand bales in 2018/19 as in 2017/18. Although Brazil produces ample cotton supplies, the textile industry often sources imports just before and during the main harvest months of June through August.

2017/18 Export Progress
For MY 2017/18, Post estimates cotton exports to clock in at almost 4.2 million bales (about 909,000 MT), which amounts to an astounding 50 percent growth on the previous season. Export growth stems from higher exportable supplies carried over from the 2016/17 production year, which falls into 2017/18 exports.

Table 2: Marketing Year Brazil Exports Statistics (in metric tons)

	2015/16	**2016/17**	**2017/18**	**% change 2017/18**

World	**939,021**	**607,171**	**908,879**	**50%**
Vietnam	142,019	82,599	189,941	130%
Indonesia	141,821	124,200	185,312	49%
Turkey	122,217	87,336	103,533	19%
Bangladesh	25,388	53,367	100,633	89%
China	100,659	41,806	79,306	90%
Pakistan	77,556	34,579	59,669	73%
Korea South	123,983	77,984	57,954	-26%
Thailand	47,072	23,175	25,599	10%

Source: Global Trade Atlas

Post had initially forecast exports at as much as 4.4 million bales (958,000 MT) for MY 2017/18. However, as the chart below shows, beginning in April, the volume of cotton exports for the 2017/18 MY dropped below the average volumes registered in the previous four export seasons. According to Post conversations with analysts in Mato Grosso, the decrease may be partially attributable to a later than usual safrinha cotton harvest in the state.

Source: Global Trade Atlas

However, a reduction in Brazil's total import demand – due to a confluence of the domestic economic downturn and the sharp currency devaluation - was likely the bigger culprit for the unexpected drop in cotton exports. Brazilian cotton exports depend on availability of containerized ships that come into the Port of Santos loaded with imports, and then make the return journey with cotton exports. According to the Cotton Exporters Association (ANEA), by September 2018, total import volumes dropped so much that only three ship lines were leaving the port of Santos on the weekly basis, instead of the typical six. Competition with coffee and sugar exports - also shipped from Santos - compounded difficulties for cotton exports. Nevertheless, availability of export lines is expected to return to normal levels as imports rebound in the coming months on the back of a stronger Real. Meanwhile, market sources do not expect logistics to significantly impact cotton exports in the 2018/19 season.

Imports in 2017/2018 totaled 82 thousand bales, less than half the volume (189 thousand bales) imported the previous season. In the 2016/17 MY, Brazil struggled with drought, which heavily impacted the domestic crop, and as a result the government had temporarily lowered the import tariff to zero for cotton imports between February 2017 and July 31, 2017 leading to import surge at that time.

CONSUMPTION

For Marketing Year (MY) 2018/19, Post forecasts total domestic consumption to increase to 3.5 million bales (762,000 MT), about a 3 percent increase on last season. The growth is forecast based on higher projected investment and an increase in economic activity that is expected on the back of positive market sentiment for the incoming administration of President-elect Bolsonaro.

Post estimates total consumption for 2017/18 MY at 3.3 million bales (718,500 MT), likewise a 3 percent bump on the previous season. Despite anemic growth of the Brazilian economy, the increase in oil prices, which directly impacts production of synthetic products, underpinned the slight increase in domestic cotton demand this season. In addition, ABRAPA continues its collaboration with the Brazilian Cotton Institute and Bayer on a marketing campaign “Sou Algodao” (I’m Cotton). The campaign was launched in December 2016, and features various fashion designers and brands in Brazil using cotton as the fabric of choice for their fashion lines. The campaign was inspired by the U.S. cotton sector’s promotional efforts that began in the 1980s. The intent is to increase domestic cotton consumption by one percent a year for the next 10 years.

In 2017 calendar year (CY), the textile sector had about $45 billion dollars in revenue, registering an increase in both clothing and textile production for the first time in three years. However, the outlook for CY 2018 has dimmed. In August, Brazil’s Textile Association (ABIT) revised domestic clothing sector growth to 1 percent for CY 2018, from the previously expected 2.5 percent. ABIT attributed the slow down to the trucker’s strike in May 2018, which halted commerce across the country for more than a week, and a shorter than expected Brazilian winter, typically from June to August.

STOCKS

Post is aware that Brazilian stock figures seemingly differ greatly with statistics furnished by other agencies, including, for example, Brazil’s official data supplied by CONAB. Please note that all of the USDA official cotton estimates as well as those in this report are based on a standardized August-July MY that applies to all countries worldwide. For example, USDA’s MY 2017/18 runs from August 2017 to July 2018 and correlates with Northern Hemisphere countries and not Southern Hemisphere countries such as Brazil. Hence, USDA’s beginning/ending stock estimates capture Brazilian stocks mid-harvest on July 31 when they are nearly at their peak. This timing issue accounts for the relatively high stock levels and low volatility in stocks-to use typically reported by USDA and this report for Brazil.

As the main harvest takes place in June, July, and August, stocks build dramatically and then outpace domestic consumption and exports. Part of the reason for the inevitable buildup of USDA reported stocks is the structural delay between harvest and the shipment of exports. Ginning, consolidating, and transport to ports delays exports of new crop cotton and exports do not start in earnest until August, which according to the USDA MY falls into next crop reporting season.

Table 3. Cotton PSD in Bales

Cotton	2016/2017		2017/2018		2018/2019	
Market Begin Year	Aug 2016		Aug 2017		Aug 2018	
Brazil	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Area Planted	0	0	0	0	0	0
Area Harvested	940	940	1175	1175	1300	1400
Beginning Stocks	5709	5709	6929	6929	8657	8757
Production	7020	7020	9220	9220	10000	11000
Imports	189	189	82	82	75	80
Total Supply	12918	12918	16231	16231	18732	19837
Exports	2789	2789	4174	4174	5500	6000
Use	3200	3200	3400	3300	3500	3500
Loss	0	0	0	0	0	0
Total Dom. Cons.	3200	3200	3400	3300	3500	3500
Ending Stocks	6929	6929	8657	8757	9732	10337
Total Distribution	12918	12918	16231	16231	18732	19837
Stock to Use %	116	116	114	117	108	109
Yield	1626	1626	1708	1708	1675	1711
(1000 HA), 1000 48 lb. Bales, (PERCENT), (KG/HA)						

Table 4. Cotton PSD in 1,000 Tons

Cotton	2016/2017		2017/2018		2018/2019	
Market Begin Year	Aug 2016		Aug 2017		Aug 2018	
Brazil	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Area Planted	0	0	0	0	0	0
Area Harvested	940	940	1175	1175	1300	1400
Beginning Stocks	1243	1243	1509	1509	1885	1907
Production	1528	1528	2007	2007	2177	2395
Imports	41	41	18	18	16	17
Total Supply	2813	2813	3534	3534	4078	4319
Exports	607	607	909	909	1197	1306
Use	697	697	740	718	762	762
Loss	0	0	0	0	0	0
Total Dom. Cons.	697	697	740	718	762	762
Ending Stocks	1509	1509	1885	1907	2119	2251
Total Distribution	2813	2813	3534	3534	4078	4319
Stock to Use %	116	116	114	117	108	109
Yield	1626	1626	1708	1708	1675	1711
(1000 HA), (1,000 tons), (PERCENT), (KG/HA)						