

USDA Foreign Agricultural Service

GAIN Report

Global Agricultural Information Network

THIS REPORT CONTAINS ASSESSMENTS OF COMMODITY AND TRADE ISSUES MADE BY
USDA STAFF AND NOT NECESSARILY STATEMENTS OF OFFICIAL U.S. GOVERNMENT
POLICY

Required Report - public distribution

Date: 4/1/2016

GAIN Report Number: BR1606

Brazil

Cotton and Products Annual

Exchange Rate Volatility Impacts Planting Decisions

Approved By:

Clay Hamilton, Agricultural Counselor

Prepared By:

Nicolas Rubio, Agricultural Attaché

Report Highlights:

Post forecasts cotton planted area for 2016/17 to increase to 980,000 hectares based on higher domestic prices and export demand. Production for 2016/17 is forecast at 7 million bales (1.52 million metric tons). The economic crisis in Brazil will continue to put downward pressure on domestic demand and make the export market more attractive for producers.

COTTON PRODUCTION

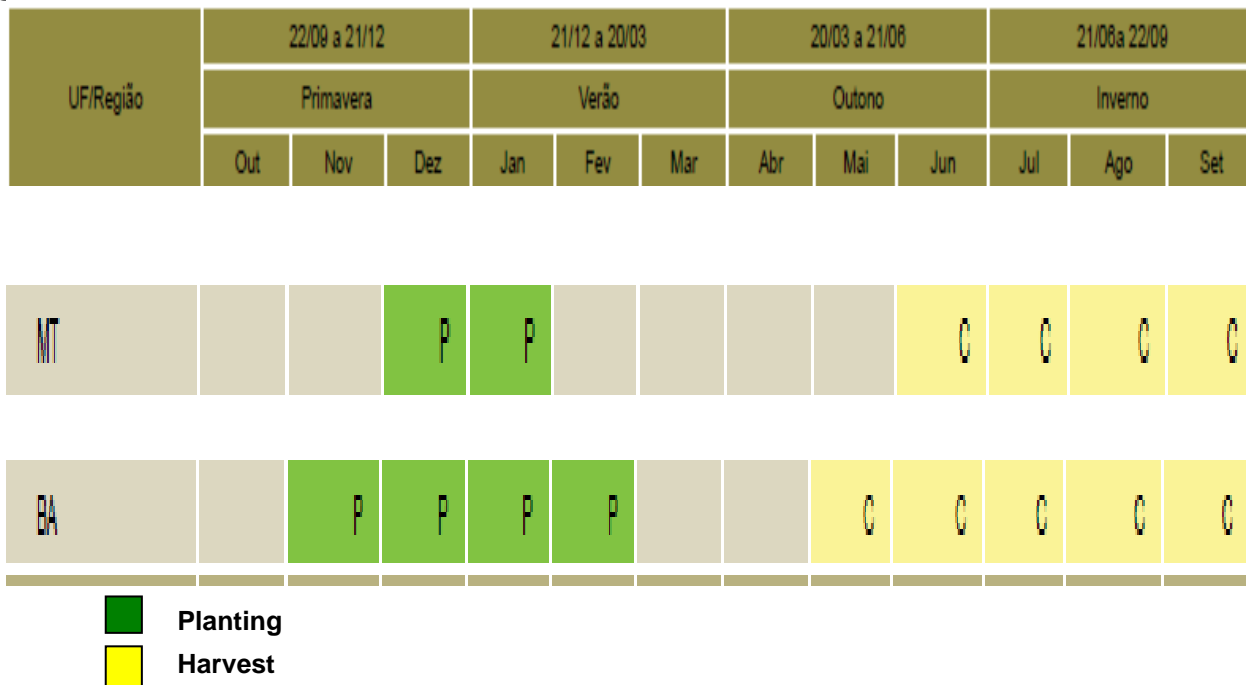
Outlook 2016/17: Cotton Production Estimated at 7 Million Bales

Post forecasts Brazil's 2016/17 cotton area to increase to 980,000 hectares (ha), three percent higher than to 2015/16. The increase is based on higher domestic prices due to the expected weak Brazilian Real (Real). Production is forecast to increase to 7 million bales (1.52 million metric tons), about three percent higher compared to the 2015/16 season. The high cost of production and high financing costs will also put a damper on additional expansion.

Post forecasts Mato Grosso (MT), the biggest cotton producing state in Brazil with about 61 percent of total area, to have the biggest increase in planted area. Post forecasts area in Mato Grosso at about 610,000 ha. Based on discussions with the cotton industry in Mato Grosso, it is expected that about 80 percent of the cotton area in the state will be planted starting late December and January. Because of the soybean profitability in Brazil, farmers plant soybean varieties as early as mid-September as a first crop followed by cotton plantings as a second crop. Planting cotton as a second crop helps reduce the risk of pests and works well for crop rotation purposes.

The state of Bahia, the second most important cotton producing state, with about 26 percent of total area, is forecast to plant about 250,000 ha. The area for Bahia is forecast to stay at the same level as the 2015/16 season due to high costs of production and challenges accessing credit. Since the rains arrive to Bahia later than in Mato Grosso, cotton is more of a full season crop. At the same time, many farmers in western Bahia have invested over the past few years in irrigation systems as insurance against dry spells.

Graph 1: Cotton Calendar – Planting and Harvesting for Mato Grosso and Bahia



Source: CONAB

Political/Economic Scenario in Brazil

It is important to highlight the volatile economic environment Brazilian farmers have been experiencing in the last two years as a result of the political crisis. Currently, the Brazilian President is fighting calls for impeachment due to perceived elections irregularities. Due to this difficult political environment, the Brazilian Real (Real) depreciated over 40 percent in 2015. The Real depreciation resulted in significant gains for Brazilian farmers, as they were able to buy inputs using a stronger Real in the first half of 2015 but domestic prices were protected by a weaker Real they got while selling the crop in the second half. Since cotton is priced in U.S. dollars in the international market, the weaker exchange rate increased domestic cotton prices (more Reals per U.S. dollars). This exchange rate situation cushioned the overall decrease in global prices.

This economic volatility will continue to be a factor in 2016. If the Real continues to weaken, domestic prices could increase, potentially translating into additional incentives to increase area. However, if the Real gets stronger (and global cotton prices stay at current levels), Brazilian farmers could face lower domestic prices for the 2016/17 growing season. For example, the Real appreciated by 10 percent overnight against the U.S. Dollar back on March 11, 2016 based on expectations of political changes. However, this situation could expand or revert depending on the political scenario this year. According to the Brazilian Central Bank, the average exchange rate in 2015 was R3.34 per U.S. Dollar. For 2016 and 2017, the Central Bank's outlook for the value of the Real is 3.99 per U.S. Dollar and 4.17 per U.S. Dollar, respectively.

Farmers are also expecting less support from the Brazilian Government (GOB). Every year, the Ministry of Agriculture, Livestock, and Food Supply (MAPA), announces its "Plano Safra", a program that offers credit to cover production costs. However, availability of subsidize loans under this program are expected to be lower compared to last year due to the difficult economic situation the country is expected to face in 2016 and possibly into 2017. A portion of the program offers low interest (subsidized) production loans. The lower amount of loans is expected to contribute to the higher cost of production forecasted for next growing season.

For the 2016/17 production cycle, the economic challenges expected in Brazil and higher production costs could potentially affect the bottom line for cotton farmers. As farmers begin to make planting decisions for the 2016/17 crop, the expected weak value of the Real is expected to make increase the cost of inputs. See table 1.

Table 1: Estimated Production Costs for Cotton in Mato Grosso (Reals per ha)

	2015/16	2016/17*	% Change
Costs of production			
Seeds	755	858	+14
Fertilizers	1,576	1,700	+8
Herbicides	2,978	3,617	+21
Machinery Operation	281	301	+7
Labor	77	77	0
Other Expenses			
Technical assistance, transportation, storage, classification, and taxes	1,293	1,408	+9
Financing Expenses			
Interest payments	684	805	+18
Total Operational Costs	R7,644	R8,766	+15

Source: Mato Grosso's Institute of Ag Economics (IMEA)

*Estimate

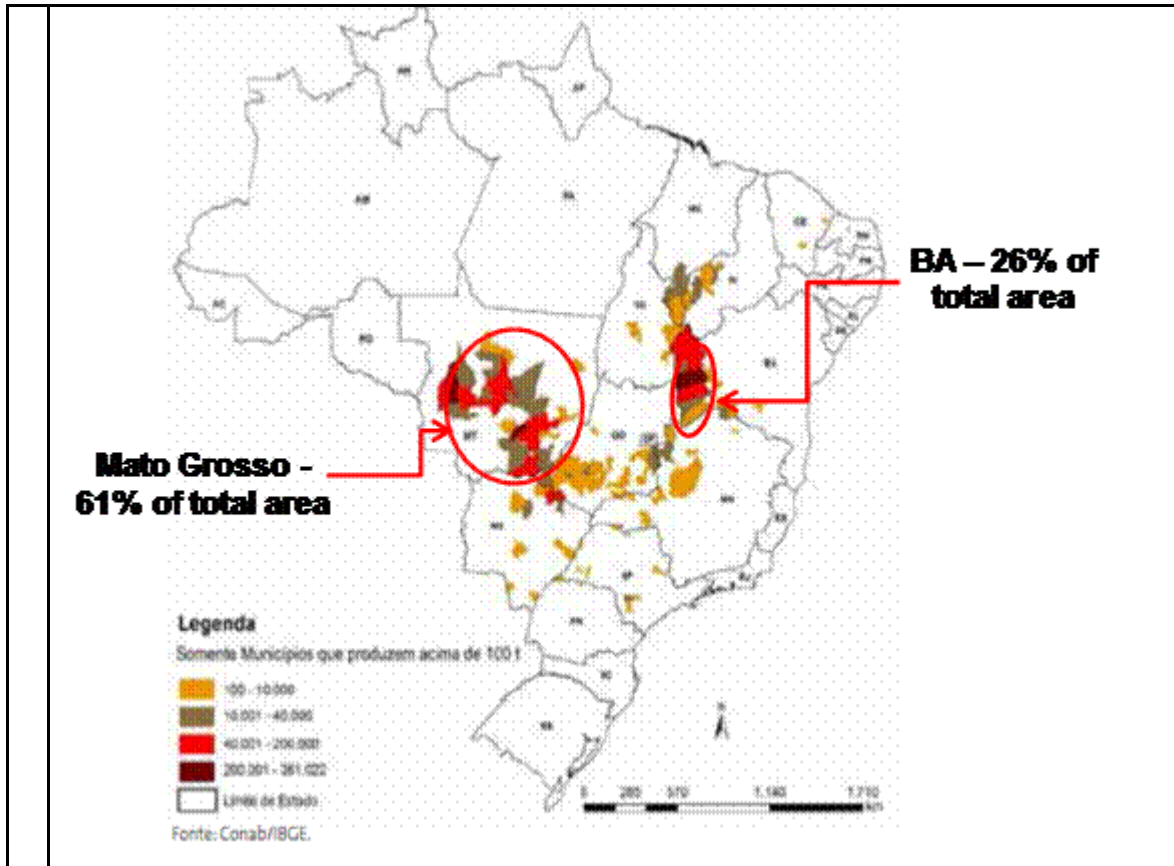
2015/16 Progress: Cotton Production Estimated at 6.8 Million Bales

Post forecasts 2015/16 area planted to cotton at 950,000 hectares (ha), an area reduction of seven percent compared to 2014/15. Cotton production is forecast at 6.8 million bales (1.48 million metric tons). However, the drop in area and production is much lower than originally expected back in November 2015 as a result of the weakening of the Real, which increased domestic prices to the highest levels in over four years.

As a result of the higher domestic prices, Mato Grosso reacted by increasing area by 3 percent as about 70 percent of cotton area in the state was 2nd crop (planted starting late December 2015). However, dry and hot weather in this state in November and December delayed the planting progress of soybeans, which had an effect in the planting window for cotton as a second crop. According to industry contacts, cotton plantings in the state should be done by the first week of February. However, for the 2015/16, it is estimated that only about 30 percent of the total second crop plantings were done by that window. This situation can potentially impact yields.

The increase in Mato Grosso was offset by reductions in the Northeast region, mainly Bahia (about 11 percent) and Piaui (52 percent). These regions were affected by drought for the third year in a row as well as high costs of production. In the Center-West region, area reductions also took place; mainly in Mato Grosso do Sul (5 percent) and Goais (13 percent), as a result of higher costs of production and the high cost to borrow money.

Graph 2: Planted Cotton Area for 2015/16 in Brazil



PRICES

Sharp Depreciation of the Real Impacts Domestic Prices for 2015/16

In Brazil, the sharp Real devaluation has been the biggest economic story. In 2015 alone, the Real depreciated over 40 percent against the dollar. As a result, the Real depreciation pushed up cotton domestic prices to the highest levels in four years despite the relative lower global cotton prices (A-Index). Domestic prices followed the A-Index trend for some time until February 2015. Since then, domestic prices have gone up by 40 percent.

This situation has helped farmers with the infrastructure to produce cotton and those who plan to use cotton as part of their rotation practices. As a result of the weaker Real, the cost of production,

especially for seeds, fertilizers, and pesticides, has also gone up tremendously as most inputs are imported and their prices are based on dollar terms. Between September 2014 and September 2015, the cost for seeds, fertilizers, and pesticides, went up by 10 percent, 37 percent, and 32 percent, respectively. In addition, producers are also facing higher energy and labor prices, as well as higher interest rates for production loans.

Table 2: Cotton Domestic Prices in cents of R\$ per lbs (2012-2015)

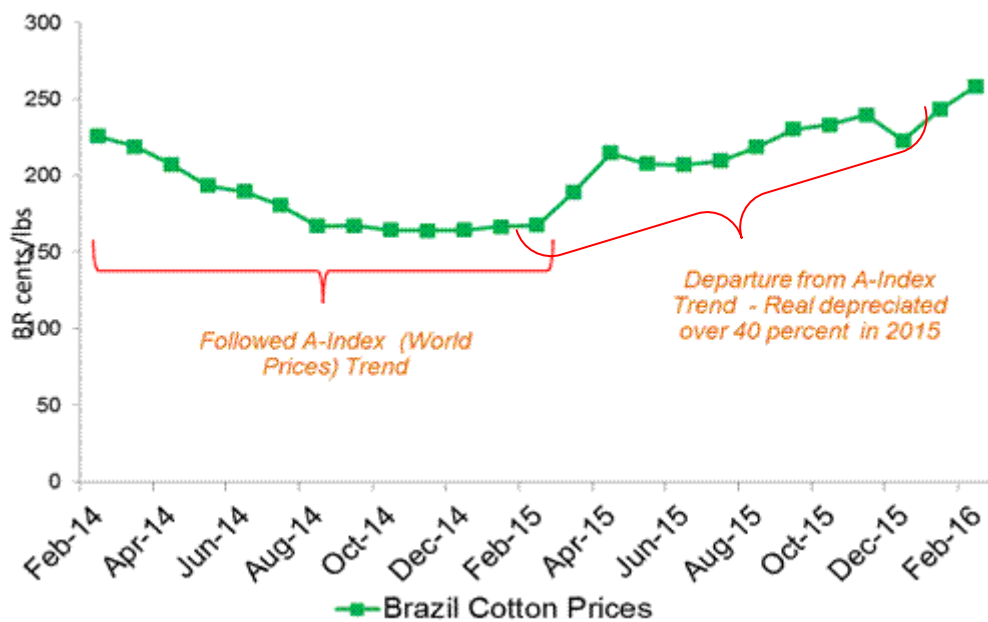
	2012	2013	2014	2015	2014/2015 % Change
January	R\$170.76	R\$175.01	R\$220.82	R\$166.67	-25%
February	R\$170.23	R\$184.47	R\$225.60	R\$167.71	-26%
March	R\$161.17	R\$204.98	R\$218.89	R\$189.29	-14%
April	R\$160.44	R\$209.49	R\$207.20	R\$214.80	4%
May	R\$160.07	R\$197.08	R\$193.55	R\$207.48	7%
June	R\$151.16	R\$193.74	R\$189.63	R\$206.98	9%
July	R\$157.56	R\$211.80	R\$180.53	R\$209.63	16%
August	R\$162.06	R\$216.38	R\$167.08	R\$218.46	31%
September	R\$165.19	R\$212.80	R\$167.28	R\$230.37	37%
October	R\$155.21	R\$214.04	R\$164.30	R\$233.27	42%
November	R\$155.49	R\$208.73	R\$163.93	R\$239.63	46%
December	R\$158.44	R\$212.46	R\$164.34	R\$243.15	48%

Source: Center for Advanced Studies in Applied Economics (CEPEA)

* Cotton grade 41-4, staple 30/32mm, 8-day term payment, no interstate commerce tax (ICMS).

Includes freight for point of delivery Sao Paulo city.

Graph 3: Cotton Domestic Prices (Monthly Average) in Brazilian Reals (Feb 2014-Feb 2016)



Source: Center for Advanced Studies in Applied Economics (CEPEA)

TRADE

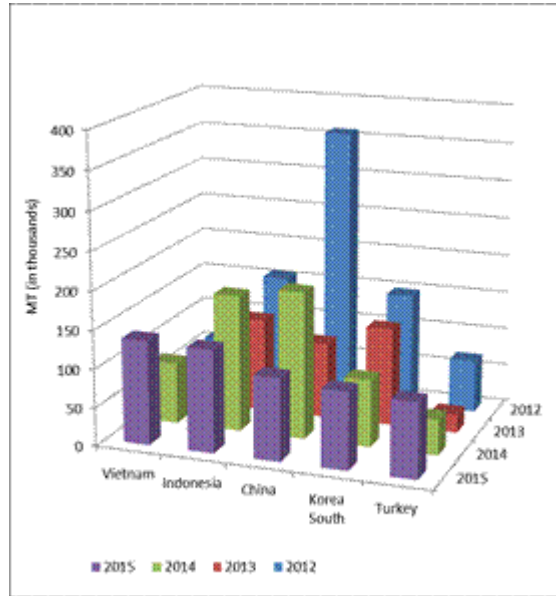
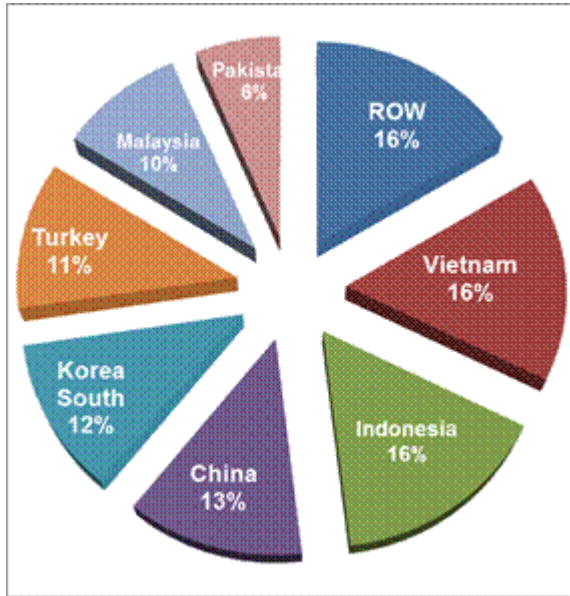
EXPORTS

Post forecasts cotton exports for the 2016/17 marketing year (MY) to slightly increase to 4.1 million bales (900,000 mt) compared to last MY. The economic and political challenges in Brazil are expected to continue to heavily impact the value of the Real, giving Brazilian cotton an export advantage over other suppliers. In addition, the lower domestic demand as a result of the economic situation is making the export market more attractive for producers.

For 2015/16 MY, post forecasts cotton exports at 4 million bales (875,000 mt) also as a result of the relative weaker domestic currency, which is making Brazilian cotton attractive for importers. China's high stocks have reduced their demand for Brazilian cotton; however, markets like Vietnam and Turkey are importing more from Brazil. Indonesia and Korea continue to be stable markets for Brazil.

Graph 3-4: Cotton Export Markets for Brazil

Brazil's Major Export Markets in CY 2015 and Brazilian Cotton Exports by Year and Destination (CY2012-2015)



Source: Global Trade Atlas

Table 3: Marketing Year Brazil Cotton Exports (in metric tons)

Brazil Export Statistics		
Commodity: Cotton,		
Marketing Year (Aug-July)*		
Partner Country	Unit	Quantity

		2012/2013	2013/2014	2014/2015
World	T	952,477	498,273	867,778
Indonesia	T	151,816	115,435	185,506
China	T	311,255	98,311	181,181
Vietnam	T	54,968	39,132	99,381
Korea South	T	145,350	97,303	95,659
Turkey	T	50,712	19,325	71,157
Malaysia	T	33,090	23,498	44,289
Thailand	T	40,403	26,049	43,398
Pakistan	T	59,401	6,317	41,519
Taiwan	T	35,211	36,761	36,877
Bangladesh	T	8,223	4,512	18,692
Japan	T	25,047	13,006	16,180
Ecuador	T	5,077	4,848	7,571
Portugal	T	5,805	4,275	4,756

*MY 2015/16 (August 2015-July 2016)

Source: Global Trade Atlas

IMPORTS

Imports are forecast at 30,000 bales (6,500 mt) for the 2016/17 MY. A slight economic recovery in 2017 supports the small increase. For 2015/16 MY, imports are forecast to drop to 20,000 bales (4,400 mt) as a result of the negative market conditions and strong U.S. Dollar. In 2014/15 MT, Brazilian imports from the world drop by 84 percent. See Table 4.

Table 4: Marketing Year Brazil Cotton Imports (in metric tons)

Brazil Import Statistics				
Commodity: Cotton				
Marketing Year (August-July)*				
Partner Country	Unit	Quantity		
		2012/2013	2013/2014	2014/2015
World	T	14,088	33,875	5,322
Burkina Faso	T	-	7,974	1,911
Argentina	T	581	1,869	952
Egypt	T	1,376	1,376	850
Benin	T	-	143	484
Cote d Ivoire	T	-	-	300
Spain	T	176	89	270
Israel	T	601	164	206
Paraguay	T	1,817	2,069	169
United States	T	9,390	17,197	136

*MY 2015/16 (August 2015-July 2016)

Source: Global Trade Atlas

CONSUMPTION

Negative Economic Outlook Affecting Domestic Demand

The unfavorable Brazilian economic scenario in 2016, which can potentially extend to 2017, is making it unlikely that the textile industry will rebound in the short term and increase domestic cotton demand.

Post consumption outlook for the 2016/17 MY is 3.2 million bales (690,000 mt), a three percent increase compared to the previous MY. The outlook is slightly higher than the previous year based on a slight economic recovery in Brazil for 2017. However, relatively high inflation expected for 2016 and 2017 will still keep consumption at the second lowest level in ten years.

For 2015/16 MY, post forecasts domestic consumption to drop to 3.1 million bales (675,000 mt) as a result of higher inflationary pressures, a major contraction of the Brazilian economy, and higher domestic cotton prices as a result of the weaker Real. The total domestic consumption of cotton is expected to reach the lowest levels in 10 years. The decline is also due to the global trend of increased use of synthetic fibers as a more competitive option.

Grading and Classification Improvements

Grading and classification in Brazil is a private-led initiative. At the same time, there is an initiative by the producers association to work with the government to get all the laboratories in the country to have uniform grading standards. This initiative is a result of problems over the years with different cotton quality in the country, which has hurt the image of the Brazilian product. One of those initiatives is a new quality cotton lab being built in Brasilia to be used as a reference lab.

In helping improve its grading and classification system, the sector has also set up a system that supports the High Volume Instrument (HVI) testing. This system facilitates the identification of samples sent to laboratories all over Brazil. Brazil's classification by HVI is measuring parameters such as length, micronaire, uniformity, and strength in order to market a product that meets the requirements of the main buyers.

STOCKS

Clarification on Beginning/Ending Stocks Estimates

All of the USDA official cotton estimates as well as this report are based on an August-July MY. For example, MY 2015/16 (August 2015-July 2016) correlates with Northern Hemisphere countries and not Southern Hemisphere countries such as Brazil. Hence, USDA's beginning/ending stocks estimates capture Brazilian stocks mid-harvest on July 31st when they are at nearly 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 as harvest progress outpaces 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 initially and exports do not start in earnest until August.

POLICY

Government Support for Commercialization and Export

Total government support across all commodities was dramatically reduced in 2015 due to the budget cuts by the Brazilian Government. For 2016/17 MY, post does not foresee any funding going into the cotton sector. In addition, cotton did not get any support in 2015/16 MY as a result of the higher commodity prices as a result of the weak Real, which made Brazilian exports more profitable (in Reals).

The government has the opportunity to update the minimum price for its programs once a year, and the price varies by commodity and classification, and by region of the country. This typically takes place in May/June of each year.

STATISTICS

Production, Supply and Demand Statistics:

Cotton	2014/2015		2015/2016		2016/2017	
Market Begin Year	Aug 2014		Aug 2015		Aug 2016	
Brazil	USDA	New	USDA	New	USDA	New

	Official	Post	Official	Post	Official	Post
Area Planted	0	0	0	0	0	0
Area Harvested	1020	1020	950	950	0	980
Beginning Stocks	7668	7668	7432	7657	0	7527
Production	7000	7000	6700	6800	0	7000
Imports	24	24	50	20	0	30
MY Imports from U.S.	0	0	0	0	0	0
Total Supply	14692	14692	14182	14477	0	14557
Exports	3910	3985	4200	4000	0	4100
Use	3500	3200	3200	3100	0	3200
Loss	-150	-150	-150	-150	0	-150
Total Dom. Cons.	3350	3050	3050	2950	0	3050
Ending Stocks	7432	7657	6932	7527	0	7407
Total Distribution	14692	14692	14182	14477	0	14557
(1000 HA) ,1000 480 lb. Bales						