



CHINA TRADE TALKS CONTINUE TO LEAVE COTTON IN DARK



CAN COMMERCIAL COTTON ARISE FROM THE CHAOS OF ZIMBABWE



INDIA INTRODUCES BASIC INCOME FOR FARMERS



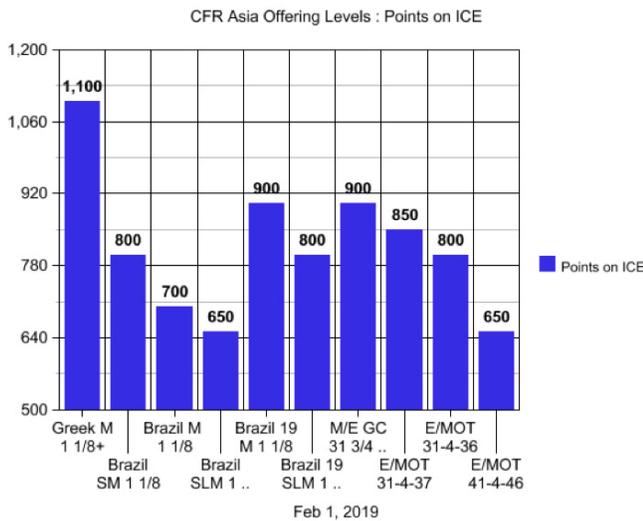
ICE FUTURES NEED CHINA/US TRADE DEAL TO MOVE HIGHER



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## US & BRAZILIAN COTTON MOVES IN VOLUME WITH BASIS LEVELS CHEAP



The reopening of the USDA has resulted in the first confirmations that US cotton moved in volume during the shutdown. However, Brazilian cotton has also sold in volume. One common feature between the two - cheap basis. Merchants want to move the 2018 Brazilian crop before a record 2019 crop arrives in about seven months. Brazilian cotton is stored outside on pallets under tarps, which is not conducive to long storage periods. Moreover, the large volume sold under pre-finance terms means the receivers want to turn it into cash ASAP.

Last week, Brazilian 2018 and 2019 crop both sold in

volume, as merchants were willing to discount basis levels in order to move them. US basis levels remain cheap, as quality discounts drive sales. The USDA released sales data for the week ending December 20th that indicated brisk sales of 373,100 running bales of upland and 7,800 of Pima for 2018/19 shipment. There were no surprises in the report. Vietnam was the largest buyer, but the Subcontinent was also active, with Bangladesh, Pakistan and India all buyers. Turkey was back in the market, and even a small volume moved to China.

As of December 20th, total US export sales were good at 11,082,792 480 lb bales, but the issue concerns

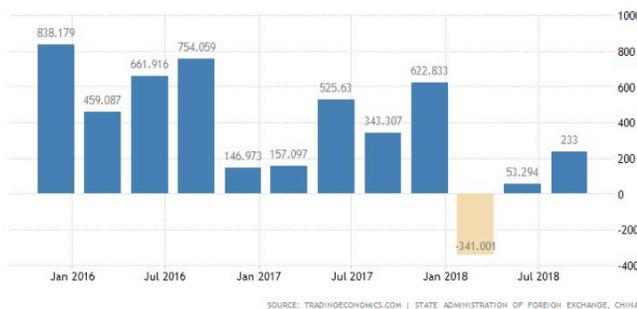
shipments, which remain well below the needed level to meet export targets. Shipments totaled only 207,100 running bales of upland and 14,200 of Pima, while the US needs to ship 363,182 bales a week to meet USDA targets. Shipments to Turkey have totaled just 5,400 bales of Pima and 172,000 bales of upland, but the US needs to ship at least 1.5 million bales. There are 1,178,100 bales of upland and 109,900 running bales of Pima that are sold but remain unshipped to China.

Brazilian 2018 and 2019 sales of Strict Middling 1 1/8 and M 1 1/8 are now popular with Asian spinners. Merchants have discounted SM 1 1/8 sales to 800-850 points on March, which is below the offering levels out of most shippers. New crop sales for September-December have been noted at the same levels, and Indonesia, South Korea, and Thailand have all been mentioned in turnover. Pakistan remains focused on discounted US styles. As ginning of the 2018 Brazilian

crop has progressed, the quality of the 2018 crop has become more mixed, with color grades appearing in merchant offers that are an assortment of Middling Light Spotted, SLM Light Spotted, and Middling Spotted at further discounts. Mexican 2018/19 crop offers also continue at a discount to both Brazilian and US styles, and most current offers are for Middling 1 1/8 and lower qualities.

For the US, the hurdles are increasing shipments and maintaining steady volume sales to Turkey, the Subcontinent, and the access to China for the remaining sales, which were all made at much higher prices. The ability to move US shipments back above 350,000 bales a week will be a challenge given the recent government shutdown and its impact, with CCC loan entries and redemptions slowing progress. We continue to see challenges with export shipments moving past the 13.5-14.0 million bales level.

## US/CHINA TALKS CONTINUE; WHAT IF CHINA'S CURRENT ACCOUNT DEFICIT LIMITS BUYING POWER?



The US/China trade talks moved forward last week as fears rose that current developments would impact the negotiations. US officially charged Huawei with bank fraud and stealing trade secrets, and formerly requested the extradition of their CFO from Canada to the US. The case states that Huawei set up an internal committee to provide monthly bonuses to employees that stole intellectual property from other companies. The theft was linked to intellectual property from US carrier T-Mobile.

India also launched an investigation into whether Huawei hacked a state-run telecom company. All of this broke as the Chinese delegation arrived in the US. Based on a Canadian investigation, an estimated two trillion USD of proceeds from illegal activities flowed out of China to the US, Canada, Australia, and the Netherlands since 2010, involving as many as 18,000 people laundering money through real estate and

business transactions. Such activities certainly gave the US team some pause. The Davos World Economic Conference ended with famous hedge fund and globalist George Soros giving a speech offering strong criticism of Xi Jinping, quite a change from the standing ovation Xi received at the event two years ago.

One theory that has evolved amid the economic slowdown and sudden critique of Chinese finances is centered on China's move from a current account surplus, where it was an exporter of capital to a current account deficit where it is an importer of capital. This theory explores whether China has the funds to completely zero the US trade deficit. Adding to this concern is China's sudden move to use a host of tools, such as Perpetual Bonds, to raise funds and announcements that Chinese banks will need to raise massive funds in 2019. UBS estimates Chinese banks will need 1-3 trillion Yuan, over 440 billion USD, to

meet the shortfall between deposits and lending.

This has added to new concerns over whether the pledges to increase purchases of US goods will be finalized, or if they will even occur. Nonetheless, last week's advanced talks ended with a high-level meeting at the White House with Chinese Vice-Premier Liu He. At the meeting Liu caused some confusion when he told Trump that China would purchase 5 MMT a day of soybeans, which of course was a misstatement. The purchase was praised by Trump who said, "That's a tremendous purchase, which will take place now and our farmers are going to be very happy. On behalf of our agricultural industry and on behalf of our farmers, frankly, we appreciate it very much. That's a very big order." The most disappointing aspect of this was that there was no mention of other purchases of agriculture products, and no mention of assured access for US products. US Treasury Sec. Mnuchin and Trade Rep.

Lighthizer are headed to China for further negotiations. China has invited US President Trump to a Summit with Xi Jinping on Hainan Island after his meeting with North Korea.

The move by China to make such a high-level announcement of a 5 MMT Soybean purchase so high-profile is a bit strange. First, the agriculture markets expected some large-scale purchases by China in December, but these did not occur. There has been total silence since then. Even with the 5 MMT purchase, Soybean purchases since December 1st have totaled only 10 MMT, which does not change the US balance or provide ongoing access. On Friday, the US released a statement in which China had agreed to a large sale of US products, including agriculture, but provided no details, leaving the agriculture markets once again in the dark.

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## ZIMBABWE: CAN COMMERCIAL COTTON FARMING RETURN AFTER SOCIALISM RUINED THE COUNTRY?



Zimbabwe (or Rhodesia as it was named before Socialism came to rule) was called the "Jewel of Africa" in 1980 due to its modern roads, airports, and infrastructure, and the fact that it had the most productive commercial farming sector on the continent. Then came the ill-advised intentions of the UK and US governments, which paved the way for the country to be turned over to the Socialist madman, Mugabe, who followed the Socialist playbook, "How To Kill A Country." The country was known as the breadbasket of Africa for its large production of grain, cotton, flower, and other agriculture products. The foundation of that production was approximately 4,000 commercial farmers who were the largest employer in the country and accounted for 40% of Zimbabwe's exports. Mugabe



was just like every other Socialist dictator. He was cruel, corrupt, and he never lost an election. With the help of the military, he managed to rule for 37 years before being ousted in a coup.

So much for the great democracy that the UK and USA promised. For the mostly white commercial farmers, the first 15-20 years went well, with operations expanding. In 1999/2000, the country produced 590,000 bales of cotton, which was of excellent quality and sought out by top spinners worldwide, with Italy the top market. From the early 1950s-1970's, Rhodesia also had a robust small-textile industry. This cotton was grown mostly on 300 commercial operations. These were large-scale commercial grain operations with all the modern

tools. It was not long before Mugabe started to attack the opposition, and up to 30,000 people died in the massacre of civilians in Bulawayo.

Conditions for the commercial farmers started to collapse in 2000, when Mugabe came under threat at the ballot box. He then launched a major crackdown on any political opposition, and soon turned his wrath on the commercial farmers who had begun to support the opposition. In 2001, the government launched an effort to nationalize the commercial farms owned by whites and others that opposed the regime, without compensation. This triggered an overall collapse in the economy, which resulted in attempts to nationalize industries. The farms were given over to allies of Mugabe that were inexperienced and lacked resources, resulting in a collapse in production when the modern farms fell into disarray. In 2005, Mugabe launched a major effort to wipe out and destroy all opposition, disrupting an estimated 700,000 people.

Cotton production did not suffer the same fate, due to a small-holder cotton input scheme that was implemented by the Cotton Company of Zimbabwe (which became known as COTTCO). The Cotton Company of Zimbabwe was formed in 1994 and grew into a ginning and merchant company that provided inputs to small farm holders, an extension service which educated and trained farmers, and then purchased the seed

cotton. This worked well and was quite successful in establishing a widespread group of small-holder growers, with COTTCO maintaining ginning and assuring cotton quality.

By 2005/2006, cotton production had returned to 490,000 bales. The success of COTTCO drew an influx of new ginning companies and small merchants. Some of these groups provided inputs and competed with COTTCO, while others attempted to buy seed cotton from growers at higher prices. This resulted in the growers defaulting on the company that had provided the inputs. This, of course, caused financial losses and resulted in a sharp decline in the quality of Zimbabwe lint. The government in the meantime was rather ineffective, as Zimbabwe's economy continued to descend into chaos under the failed policies of Socialism and Mugabe.

Cotton production continued to increase for a while, peaking at 675,000 bales in 2010/11. As a result of the financial losses due to side marketing deals, general corruption, and the complete disintegration of the economy, cotton production collapsed, falling to only 53,000 bales in 2015/16. During this time of rampant inflation, the Zimbabwe dollar was discontinued, and the USD became its tender. When cotton production finally collapsed, many of the private ginners were forced to close. Even COTTCO had to go through reorganization.



*Modern Rhodesia/Zimbabwe farms, post 2000*



*Major citrus state, prior 2000*

Eventually, Mugabe's own party forced him to retire in 2017, and one of his team, Mnangagwa, became president. He entered office promising reform, offering a proposal to begin paying commercial farmers for land stolen years before. Old Socialists never really reform, however, and in January 2019 the country once again descended into chaos amid the continued Socialist policies that have left people without basic services, food, and health care. Protesters have been met with violent repression. At the height of the protest, Mnangagwa was in Russia seeking investment in the country's new mining sector.

The country's only major supporters are China and

Russia. US involvement has been nil since it helped start the spiral of destruction under President Jimmy Carter, and the UK has had minor involvement, as it shrunk from international leadership. The campaign to attack and murder any opposition group has prevented alternate leadership from developing, and this has left the country without competing voices and options. US and UK leadership is needed, but both are preoccupied with other issues. The cotton sector's best hope appears to be a strong revival of COTTCO and other commercial companies that are willing to brave the economic conditions. The country does not have a currency, and the USD is in use in hybrid bonds, along with the USD.



Regarding cotton, the input scheme was revised, and production in 2018/19 recovered to 230,000 bales of lint. COTTCO is back in full operation and is in discussions with Wilmar International Ltd for a 50% stake that would provide financial security. Wilmar is a major oilseed crusher headquartered in Singapore. It appears Zimbabwe is headed along the same path as Venezuela, however. Other than China or Russia, it has no allies to count on for support, and opposition remains very weak. Nevertheless, an announcement by COTTCO has created interest and attention. COTTCO

announced it wants to develop irrigated commercial cotton farming on 40,000 hectares of land; 20,000 in the Kanyomsa district, and 20,000 hectares in the Mushunsi district. The Wilmar investment could provide the necessary financing. As part of the Socialist policy, the country has eliminated title deeds for private land ownership and replaced them with 99-year leases. None of the farmers given tracts of the stolen commercial farms have titles, and few have an official 99-year lease, as the government department handling such matters is closed. This might raise questions for some as to how COTTCO could get the title for 40,000 hectares of land, but in a country with no rule of laws anything is possible.

Such a revival of commercial cotton farming would boost the country's production to an additional 240,000 bales. It remains to be seen amid the chaos of the country if this scheme can get off the ground. The current 2018/19 Zimbabwe crop is a mixed quality, offers range from 1 5/32 to 1 3/32. CFR basis levels for the top Strict Middling 1 5/32 are currently at 1225 points on March, which is firm for a hand-picked cotton, and SM 1 1/8 offers are at 1125 points on. This is at a sizeable premium to Mozambique M 1 1/8, which is offered at 725 points. This indicates that the reputation of Zimbabwe's cotton quality is again being maintained.

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## WHAT IS THE LARGEST AGRIBUSINESS COMPANY IN THE WORLD? HOW CHINA STATE OWNED COMPANIES RULE MARKETS

The role of state-owned companies in China's economy is now one of the structural issues at the heart of negotiations with the US. Since Xi Jinping came to power, one of his key strategies has been to reintroduce Stalin's policies, reinvigorating the role of state-owned companies in the economy and creating the world largest companies by merging the largest state-owned groups. The mergers were not discussed in the public, and there was no public debate or discussion of merits. The government simply issued a press release announcing that a merger would occur. In many cases the mergers were very disruptive to the industries involved and followed unorthodox procedures.

One of these mega mergers occurred in agribusiness. ChemChina, a state-owned company, purchased Syngenta, and then ChemChina merged with SinoChem, another state-owned company. Each of these companies was already on the list of the top 500 global companies. Suddenly, after the Syngenta purchase was completed, it was quietly announced in the financial press that the

chairman of Sinochem would also serve as chairman of ChemChina. The announcement was made in a one-sentence statement and made no mention of a merger, which is now assumed. The sudden departure of the ChemChina chairman that had just led the Syngenta negotiation and purchase, as well as other purchases, carried with it no discussion. The Shareholder of both companies is the Chinese Communist Party.

To top that, the largest agribusiness company in the world was formed with even less press when Sinograin acquired China National Cotton Reserve Corp. The combined assets of the new company are estimated at 213 billion USD. This makes it twice as large as Sinopec, the large state-owned oil group, the largest agriculture trading company in the world, and one of the largest food companies in the world. Anheuser Busch has close to the same market cap. The surprising fact is that the company is nearly four times larger than any other agriculture trading company. Sinograin is eight times larger than ADM, with a market cap of about 25 Billion,

while Glencore has a cap of 55 Billion, Cargill 49 Billion, and Bungee 7.58 Billion USD.

There is no financial reporting associated with the company. However, a short press release of the volume of grains and cotton sold in 2018 provides an insight into the massive reach of the company. Sinograin reported that it sold 100 MMT of corn, 17 MMT of rice, 10.66 MMT of wheat, 2.5 MMT of cotton, 2 MMT of soybeans, and 420,000 tons of rapeseed in 2018. This amount of turnover did not take into consideration purchases, only

sales. No other agribusiness company in the world came close to such volumes.

The size of these companies illustrates their influence domestically and globally. It also creates quite a dilemma for China and its desire to be named a market economy. The role of the state-owned companies today is much greater than when China first joined the WTO. This discussion would appear to carry risk for China's exports continuing to receive the Most Favored Nation duty rate, if that issue is challenged.

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## BRAZIL COTTON PLANTING ACCELERATES AS ARGENTINA SUFFERS MORE FLOODING



**B**razil is rapidly planting the second crop in Mato Grosso, with planting last week moving past the 50% stage. This suggests that it will be completed during the ideal planting window. This is increasing grower selling interest, with December ICE futures nearing 75 cents. The Real/USD exchange rate continues to strengthen, ending the week at 3.65. The real strength has continued to impact local cotton prices, which ended the month at 78.86 cents a lb. base, the ESALQ Index of a 31-4-35 landed Sao Paulo. The crop in Brazil is off to a good start, and growers appear optimistic. January export shipments may have reached 120,000 tons. Domestic mills are complaining about the poorer quality of stocks not moving to export. Despite this, as discussed earlier, merchants are very aggressive in export markets. The complicated Brazilian tax scheme, with major differences between states, makes it difficult for the domestic industry, while the inability to finance inventories is also a problem.

Brazil's economy is showing further signs of

improvement, with a return of confidence as major construction projects are up 25% since the election. Total agriculture exports in 2018 reached a record 101.69 billion USD, and the December trade surplus was the highest of the year at 6.664 billion USD. Retail sales grew by 4.4% in November from a year ago. The new government announced that BR-163, the grain highway, would be paved by the end of 2019 all the way to the northern river port of Miritituba. This would be ahead of Bolsonaro's campaign promise and a major accomplishment. The Mato Grosso state assembly approved a version of the tax scheme we discussed last week that will go into effect on February 1st.

In Argentina, El Nino-induced rains continue to cause havoc, with flooding and excess water standing in fields. Losses to both crops and livestock are being reported. Last week, significant flooding occurred in parts of Cordoba and in southwest Chaco. There have been no detailed estimates regarding the total losses to what was a record cotton crop at one time.

## INDIA ANNOUNCES UNIVERSAL INCOME SCHEME FOR POOR FARMERS

As we discussed last year, just as we feared, the move to try and boost farmer’s income through a sharp increase in MSP for agriculture product has failed to provide farmers with the assured income. The MSP scheme that has been used for years has had lots of problems in execution, since it places the government in the cash business of most major commodities, a task it simply has not been able to execute. It has performed better in cotton, but at times has been expensive to the textile sector. Ahead of new national elections, the Modi government announced a universal income scheme for farmers. The government will pay farmers who own less than two hectares – an estimated at 120 million farmers – an annual payment of 6,000 rupees or 84.44 USD

annually. This will have an annual cost of 10.5 Billion USD. The Modi Govt. also sparked international outrage over a move to protect the retail sector from Amazon, Walmart, and other international mass retailers.

New crop arrivals were heavy last week, pressuring domestic prices to near 77 cents a lb., base S-6 1 1/8 ex gin. In the local yarn market, rumors are in circulation that Chinese importers have defaulted or renegotiated cotton yarn contracts worth 400-500 million USD following the decline in prices. Indian exporters remain aggressive sellers in the Pakistan market. No mention was made on the future use of the MSP or whether or not it would continue.

## US COTTON HARVEST DRAGS ON IN SOME AREAS AS QUALITY FALLS

The US harvest is dragging on in Georgia and Texas. 366,772 bales were classed last week, bringing total classings to 16,376,656 running bales. In Georgia, the crop now being classed has fallen to 49% Grade 51 last week and 10.5% 52. Texas, in contrast, is producing a higher grade 55.1% 31, and better grade crop with the

major issue being bark, which accounted for 20.8% of last week’s classings. Overall, the 2018/19 US crop will be of the poorest quality in years. Rainfall at harvest and the Hurricane were the culprits. The non-climatic features of the crop are, however, assisting exports due to the color grade discounts.

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## ICE FUTURES NEAR 75 CENTS WITH ACTIVE HEDGING PROVIDING RESISTANCE

Heavy ICE futures trade on Thursday pushed the March contract to near 75 cents. The rally was led by speculative buying but was turned back by Trade selling linked to movement of crops. The market has been steadily attempting to move higher, but the missing ingredient has been the confirmation of a meaningful US/China trade agreement. Watching the trade meeting and press releases, it has been quite astonishing that no other agriculture product besides Soybeans receives a mention. In the rumor mills or in side conversations we heard discussions of large ethanol, corn, and wheat sales being included, but not one in cotton. This comes even though the US imported nearly 40 billion USD of textiles and apparel from China, including a large block of cotton apparel.

We understand that the big focus is on structural issues that will be very difficult to resolve. However, several times, including this past week, the press has highlighted that China is offering to buy a range of US products to offset the deficit. With a 5 MMT soybean purchase getting the headlines Thursday, it is somewhat strange for no general outline for agriculture trade to emerge for debate and discussion. It seems clear that the Chinese side understands the importance of Soybeans and the farm vote to the Trump administration. The US agriculture press is also very quiet regarding details, the public's need to know, or having input.

We have discussed in detail that global cotton use came under pressure from October forward, led by China. Global cotton use has held up better than expected, and some progress in market share can be heralded. The market needs a clear resolution of the China/US trade conflict. Without it, there is just too much uncertainty hanging over the market. Export trade outside of China is brisk, but basis levels are weak and merchants want to move inventories. Amid no certainty over Chinese demand or access, the prospect of much larger Brazil and US crops will soon be a focus. The Brazil crop is past the halfway point in planting, and the US will start in a couple of months. If confidence builds in the two crops based on a successful start, then merchants and coops will begin to adjust basis levels to move the crops. We are already seeing this in Brazilian offers. It is extremely difficult for the cotton market to have any real confidence in the Chinese/US trade talks when cotton does not receive a mention.

As we discussed last week, the increased cotton import demand from India, Pakistan, and other non-Chinese cotton markets has made price performance much better than could have been expected at one time. Imports from this region could exceed commercial Chinese imports, excluding Reserve purchases. However, China's economy has slowed, and it appears growth is much lower than the official data suggests, and this is creating uncertainty. The volumes of cotton yarn imports and lint are very important to the global



market. When adjusted for yield, cotton yarn imports can account for 9-10 million bales of lint, which is much larger than recent lint imports. While there have been defaults and adjustments since prices have fallen, the internal Chinese cotton prices have been holding, which should maintain yarn imports. However, the state of flux of the Chinese market is an issue and can quickly have global price ramifications for cotton. This needs to be monitored closely. A trade deal with the US is also important for the Chinese economy.

We are entering the Year of the Pig, and the Chinese New Year Celebrations will soon leave us with a period of few new developments. The general observation is that Chinese leader Xi Jinping wants a one-on-one summit with US President Trump, which could come late in February. Jinping feels he can use such an event to finalize a deal that could even lead to the release of the Huawei CFO and ease the pressure on

the Company. Remember ZTE, which Trump provided relief for at an earlier meeting.

March cotton futures have formed a long flag and closed Friday near the major downtrend from the highs. The challenge lies in whether the downtrend can be breached, which is the goal of the speculative funds. Spinners, however, are not willing to chase the market, and merchants are willing so far to discount the basis to maintain sales. These conditions normally do not provide a bull market. Overall, we see prices in both March and December 2019 facing tough resistance as prices near 75 cents. If the Funds are successful in the push, then 80 cents is possible again in both months. However, we see such a move as very difficult or extremely short lived without the completion of a successful US/China trade deal that gives US cotton assured access.

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