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## China Cotton Reserve Auction Update

Provided by:



On June 30<sup>th</sup>, China announced to continue the practice from 2019 to rotate the reserve starting from an auction of 500,000 tons to the market. The reserve refill plan will be decided later, based on the progress of the auction and the supply and demand situation of cotton market. 8,000 tons of reserve cotton will be provided for auction each working day from July 1<sup>st</sup> to September 30<sup>th</sup>.

Based on our discussion with various sources including CCA and CCTA, the impact on the market is limited due to the following reasons.

- 1. The key intention of the auction is to improve the quality of the national reserve through rotation.** Based on limited available information, it's believed by the industry that the reserve now has about 2.1-2.5 Million MT and most of them are old cottons bought from 2011 to 2013 (besides the 371,560 MT of Xinjiang high quality cotton bought in 2019/20). After the large-scale auction in the past years, the reserve reached a "reasonable level" in quantity in 2018 and since then Chinese government has been strategically rotate the reserve to improve the quality of it. Compared with the previous auctions, 500,000 tons is a limited quantity (same as last year's reserve refill target), which the Chinese government believe that would not majorly impact the market.
- 2. The auction will satisfy the mills' structural demand for low quality cotton.** The quality of those reserve cotton is relatively low and could not be used for high quality products and therefore the industry stakeholders widely believed that it has no major impact on their demand for high quality ones despite the market price may see some short-term fluctuation when the news broke out last night. Under the hit of the Covid-19 pandemic, Chinese textile industry is suffering due to lack of orders from oversea markets. Therefore, some of the export-driven mills are also exploring domestic market and that has driven the demand for low quality cotton. The auction will provide supply of low-quality cotton with low price to support their production and will not necessarily impact the demand for high quality cotton which normally will be processed and then exported.
- 3. The flexible mechanism of the auction and the expectation of an incoming reserve refill will provide support for the cotton price.** Similar as last years' practice, the auction price will be linked with the domestic and international spot

prices and adjusted every week. A circuit breaker mechanism will be triggered to suspend the auction if domestic spot price is lower than RMB 11,500/ton and resume after price bounces back for three consecutive days. Necessary adjustments would be expected if there are any major updates in the domestic and international cotton market. Meanwhile, the expectation that a reserve refill will take place sometime also contribute to prevent the price from dropping greatly.

For U.S. cotton, the auction might squeeze Chinese market's purchase intension in short term, but in general the impact is limited and need continued observations. Though of course it can't be confirmed by the Chinese government, more people intent to believe that this move may actually create space in the reserve for purchasing the U.S. cotton to refill the reserves under the Phase One Trade Agreement. Against this background, it is vital for ACSA to continue to deliver the message on the exportable surplus of new crop through various ways to audiences from governments and industries.

Domestically the Chinese cotton and textile industries reacted calmly for this policy, as the hearsay of reserve auction was discussed in the past month and the market has already reacted by a slight price drop last week.

