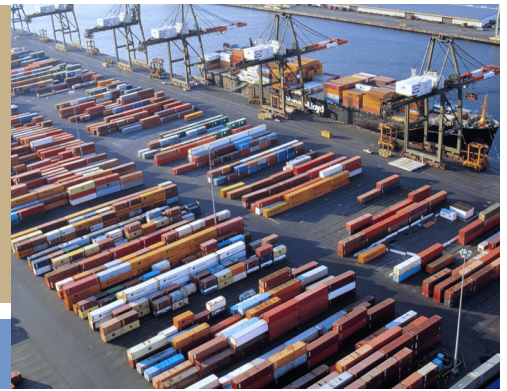


INSIGHTS

THE ECONOMY & APPAREL SOURCING TRENDS



U.S. apparel prices have been decreasing for over a decade, and the current economic crisis has only intensified the pressure for less-expensive apparel. According to Cotton Incorporated's Lifestyle Monitor™, 7 out of 10 U.S. consumers say the current economic situation has hurt them financially, and nearly two thirds (64%) say they have less to spend on clothing than last year. Faced with these difficult conditions, retailers have been relying on heavy discounting to attract increasingly price-conscious consumers.

To protect margins while lowering prices, retailers seek the lowest-cost sources for apparel. The past year has seen shifts towards sourcing of cotton-dominant apparel from Southeast Asia, due to a range of cost-related factors. Sourcing decisions may also be affected by changes in exchange rates, notably the appreciation of Chinese RMB against the dollar in recent years and weakening of the currencies of several Southeast Asian countries in recent months. These movements in exchange rates may reinforce trends towards increased sourcing from Southeast Asia, offering some relief to retailers looking to decrease costs throughout their supply chains.

SHIFTS IN SOURCING OF COTTON APPAREL

According to the U.S. Office of Textiles and Apparel (OTEXA), the total volume of U.S. apparel imports (based on square-meter equivalents) was down 2.7% from 2007 to 2008. For the first time since OTEXA began collecting data (in 1989), U.S. imports of cotton-dominant apparel declined, by 2.5%. Declines in other fiber-content categories were steeper; imports were down 18.8% for silk-dominant apparel, 4.7% for wool-dominant apparel, and 2.4% for manmade-fiber-dominant apparel.

About 60% of the decline in cotton-dominant apparel imports was due to decreases in imports from China (-3.9%), Mexico (-8.1%), and Pakistan (-1.6%), which outweighed growth in imports from all of the other top ten suppliers. Despite its decline in shipments, China was still the largest single source, supplying 26.0% of U.S. cotton-dominant apparel imports. Capturing some of China's market share was Vietnam, whose cotton-dominant imports were up 26.0%—making Vietnam the fourth-largest supplier of cotton-dominant apparel to the United States. The next-largest increases were in imports from other Southeast Asian coun-

tries—imports were up 8.3% from Bangladesh, 8.1% from Indonesia, and 5.5% from Cambodia.

While China remains the leading supplier in many cotton-dominant product categories (including dresses, underwear, and woven shirts), the last several years have seen sourcing shift towards Southeastern Asian suppliers in key product categories, including bottoms and knit shirts. In cotton-dominant bottoms, imports from Bangladesh were up 25.6%, enabling Bangladesh to surpass China as the largest supplier in this category. Growth in imports of cotton-dominant bottoms from China slowed considerably (from 30.3% for 2006 to 2007 to 8.5% for 2007 to 2008), allowing Bangladesh to take some of China's market share. Contributing to Bangladesh's strong growth in bottoms was a unit cost well below that of China (\$4.36 vs. \$6.73). In cotton-dominant knit shirts, Vietnam pulled ahead of China to become the second-largest supplier to the United States (after Honduras). Knit shirt imports were up 32.5% from Vietnam, while imports from China grew only 5.9%. The unit cost of knit shirts from Vietnam declined 4.3% from 2007 to 2008; at \$3.20, it was significantly below the Chinese unit cost of \$5.07, which was up from 2007. Thus, slower growth in cotton-dominant apparel imports from China was due not only to the current economic climate, but also to sourcing shifts towards lower-cost Southeast Asian suppliers.

CHINA'S SHARE OF APPAREL IMPORTS SHRINKS

Top 10 suppliers of cotton-dominant apparel to the U.S. (SMEs):
Share (%) of cotton-dominant apparel imports & change 2007–2008

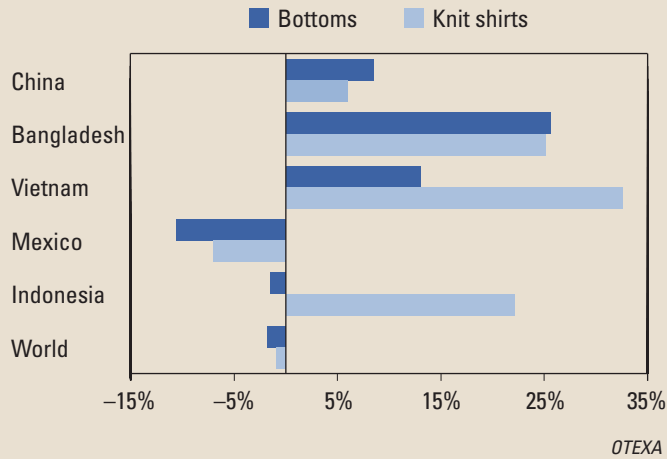
	2007	2008	% Change
China	27.4	27.0	-3.9
Bangladesh	7.0	7.7	8.3
Honduras	6.6	7.1	4.4
Vietnam	4.9	6.3	26.0
India	5.3	5.6	2.3
Pakistan	4.6	4.6	-1.6
Mexico	4.9	4.6	-8.1
Indonesia	4.1	4.6	8.1
El Salvador	4.1	4.3	1.4
Cambodia	3.8	4.1	5.5
World	100.0	100.0	-2.5

OTEXA

THE ECONOMY & APPAREL SOURCING TRENDS

SOURCING SHIFTS IN KEY CATEGORIES

% change in imports of cotton-dominant products (units), 2007–2008



other side of the coin has been a “flight from risk.” As investors have moved their investments into U.S. dollars, they have sold their investments in many other countries’ currencies, causing those currencies to depreciate.

The countries whose currencies have significantly declined against the dollar include some of the world’s largest textile and apparel manufacturers. Thus, the relative cost of apparel imports from several of the top suppliers has decreased. For example, the Indonesian rupiah has fallen 18.7% against the dollar since August 2008, meaning that in U.S. dollars, an item sourced from Indonesia cost 18.7% less in January 2009 than it did in July 2008. Noticeably absent from the list of countries whose currencies have depreciated against the dollar is China. Long criticized for preventing the RMB from rising to its true value, China has since July 2005 allowed the RMB to climb about 20% against the dollar. Since July 2008, the RMB has remained relatively stable against the dollar, making it more difficult for goods from China to compete with goods from countries whose currencies have fallen against the dollar.

COST EFFECTS OF VOLATILE EXCHANGE RATES

Declining currency values against the dollar in a number of key textile-producing countries offer another cost benefit for apparel importers. Since the start of the current financial crisis, the value of the U.S. dollar has risen sharply, reversing the downward trend it had shown since 2002. From February 2002 to July 2008, the dollar fell 27.1% against the currencies of its major trading partners (based on the U.S. Federal Reserve’s Trade Weighted Exchange Index). However, almost half of that decline has been reversed in the past few months, as the dollar strengthened by 15.7% from July 2008 to January 2009. Contributing to the dollar’s strength has been a “flight to quality”—investors have converted their assets into U.S. dollars, believing that in these uncertain times the U.S. economy may be a safer place for their investments. The

Since the financial crisis accelerated in September 2008, exchange rates have been extremely volatile, and they are likely to continue to shift in coming months and years as the world economy stabilizes. Nonetheless, the recent changes in exchange rates may present U.S. importers with opportunities for additional cost savings at a time when they are facing intense price pressure from consumers, who are seeking markdowns and lower-cost products. If retailers take advantage of more favorable exchange rates, they will accelerate current trends towards increased sourcing of apparel from Southeast Asia and help relieve tight margins throughout the supply chain. Meanwhile, a comparatively strong RMB will make it harder for China, already facing competition on labor costs, to compete on price.

RMB STAYS STRONG AGAINST THE DOLLAR, WHILE OTHER KEY SUPPLIERS SEE EXCHANGE RATES FALL

