



Potential Impact of Faster Growth in Apparel Imports

The slower economic growth witnessed in the waning months of 2006 has contributed to slow total consumer spending, including a decline in the growth of apparel spending. The U.S. Commerce Department reports that year-over-year growth in real spending on clothes, after averaging 7.1% in the twelve months of 2005, eased to average 5.9% in the first nine months of 2006 and slowed further to average just 4.8% in April through September, in line with the economic slowdown. As growth in consumer spending on clothing slowed, growth in retail apparel sales slowed in step. According to NPD, year-over-year apparel sales growth for the period July through September was just 2.4%, down from average growth of 4.5% over the previous 18 months. Of all apparel sold at retail, about 90% to 95% is imported, and slower growth in apparel imports earlier in 2006 foreshadowed the recent slowdown in retail sales. After expanding an average of 10% per year for the last 16 years, total cotton apparel imports for the first nine months of 2006 were up only 3.5% from the same period in 2005. The impact on retail sales can be traced throughout the supply chain to shifts in imports from individual countries. This issue of the *Textile Consumer* looks

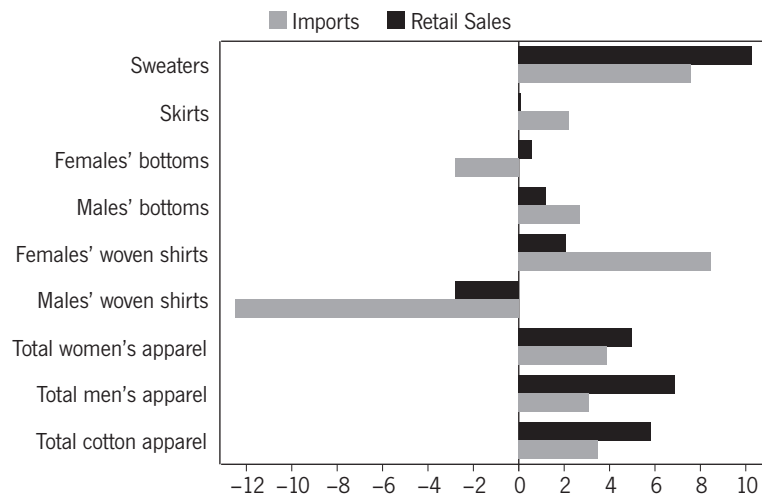
at the outlook for four key sourcing regions: China, Mexico, the Central America–Dominican Republic Free Trade Agreement (CAFTA-DR) nations, and Vietnam.

Cotton Imports by Category

Although imports of cotton-dominant apparel still are forecast to reach a record in 2006, accounting for 60.6% of total apparel imports, the slower growth in cotton apparel imports this year is being felt across a number of key product categories, including knit and woven shirts, bottomswear, jeans, sweaters, and underwear. The more moderate growth of imports and retail sales in key cotton apparel categories contributed to moderating import costs and retail prices over the first three quarters of 2006. Previous research conducted by Cotton Incorporated found that changes in import prices are an important predictor of changes in retail prices. The fact that supply (import volumes) and demand (retail sales) are climbing at comparable rates suggests that neither unit costs of imports nor retail apparel prices are likely to decline further in the near term. However, evidence indicates that consolidation of suppliers will continue and import volumes will increase in 2007, resulting in a return to apparel price deflation for imports and at retail.

% Change in Import Volumes & Retail Sales (\$ Basis)

By Product Category, Jan.–Sept. 2005 to Jan.–Sept. 2006



Source: NPD and the U.S. Commerce Department.

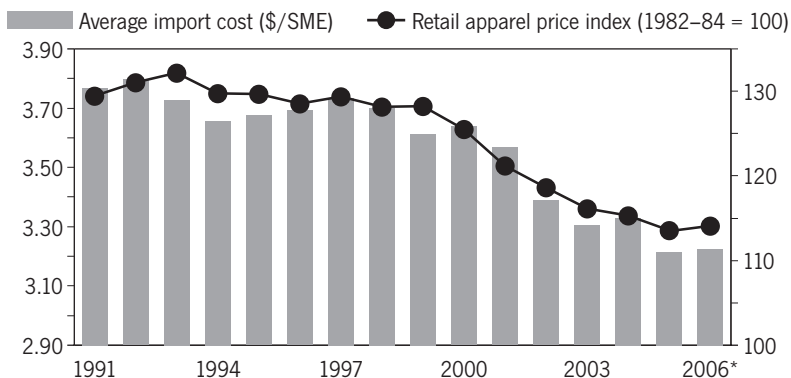
Import Volume by Supplier

Although the growth in cotton apparel imports generally has slowed across the board, import volumes from various key suppliers show a mixed bag. Imports from China, the Indian subcontinent, and Vietnam are up year over year, while imports from key Western Hemisphere suppliers are down.

Consolidation of Suppliers

Consolidation of suppliers has resulted from the lifting of quotas, retailers' ex-

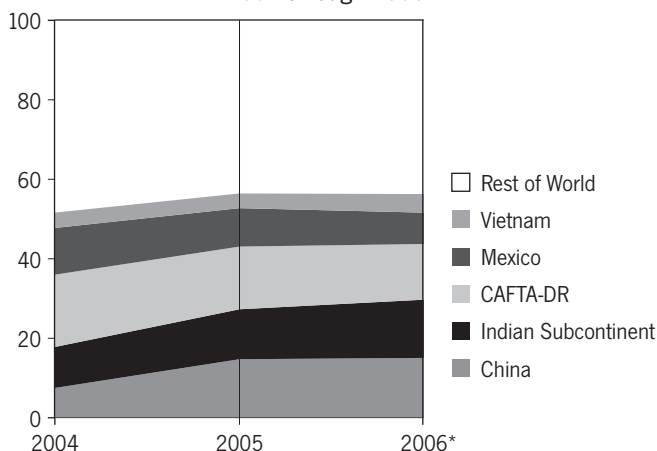
Average Cotton Apparel Import Cost & Retail Apparel Price 1991 through 2006*



Source: U.S. Commerce Department and Bureau of Labor Statistics. *Cotton Incorporated forecast.

pressed desire to work in fewer countries and with fewer suppliers, and erosion of prices in certain apparel categories. Before the global abolition of quotas at the end of 2004, the United States imported over \$1 million in cotton apparel from a record 112 countries, with the top 10 suppliers accounting for 52.3% of imports. For 2006, the top-10 share is forecast to rise to 61.0%, as the number of nations supplying over \$1 million in cotton apparel slips to 104. In the current environment, several key suppliers are likely to see shipments rise faster than from the rest of the world, suggesting that consolidation may continue into 2007.

Share (%) of U.S. Cotton Apparel Imports 2004 through 2006*



Source: U.S. Commerce Department. *Cotton Incorporated forecast.

China: #1 Supplier of Cotton Apparel

Benefiting from lower average unit costs than other key suppliers, China is likely to retain the title it

earned in 2005 as the largest supplier of cotton apparel to the United States. China is on track to increase shipments 5.6% in 2006 (on a dollar basis).

Monthly Chinese cotton apparel import volume gyrated wildly over the last two years, owing to shifts in quantitative limits on certain apparel categories. After China joined the WTO (in late 2001), Chinese cotton apparel shipments became eligible for quota-free access to U.S. shores starting in 2005. Under the terms negotiated, the volume shipped was unfettered unless the U.S. government determined it to be "market distorting,"

which could trigger a safeguard mechanism, essentially re-imposition of quotas against products shipped from China. Over the first six months of 2005, Chinese shipments of cotton apparel to the United States climbed 197.0% over the same period in 2004, causing limits to be imposed on a number of products—particularly knit and woven shirts, pants, and underwear. As a result, the volume of Chinese imports fell 36.3% from the first half to the last half of 2005. In late 2005, the United States and China negotiated a comprehensive agreement to replace the safeguard mechanism, allowing Chinese shipments to re-enter the United States, but at a more measured pace than in early 2005. This agreement applies to certain categories of apparel and spells out the specific volumes that can enter the United States from 2006 through the agreement's expiration after 2008.

% Change in Cotton Apparel Imports

Dollar Basis, Jan.–Sept. 2005 to Jan.–Sept. 2006

Category	World	Vietnam	China	CAFTA-DR	Mexico
Total	3.5	30.2	5.6	-8.7	-15.8
Bottomswear	-0.4	33.3	-24.6	-21.0	-19.9
Knit shirts	10.2	33.7	-0.3	2.2	-6.2
Woven shirts	-4.9	2.4	17.3	-7.0	-12.3

Source: U.S. Commerce Department.

Under the new agreement, the volume of cotton apparel imported from China is up 5.6% over the first nine months of 2006 and is poised to expand even faster in 2007. Import volumes of several key cotton-dominant apparel products showed a mixed

picture year over year in 2006, as growth in woven shirts (17.3%), skirts and dresses (64.0%), and coats (30.3%) offset declines in knit shirts (off 0.3%), bottoms (off 24.6%), and sweaters (off 29.0%).

Chinese shipments may climb faster in 2007, for two key reasons. First, the terms of the comprehensive agreement will increase the quotas for certain key categories in 2007 and again in 2008. Second, Chinese shipments are running behind the pace necessary to fully utilize the 2006 quota. For example, from January through mid December 2006—97.0% of the calendar year—imports of knit shirts totaled only 77.8% of the available quota. These facts suggest that there is room for faster growth not only as a result of increased quotas, but also through increased quota utilization. But even if Chinese shipments increase only as fast as the quotas (12% to 15%), they are likely to outpace both rest-of-world shipments and growth in retail sales. This scenario—in which Chinese shipments (supply) have the opportunity to grow faster than retail sales (demand)—suggests a return to price pressure on imports and to retail price deflation in 2007.

Mexico: Higher Costs, Lower Volumes

From soon after implementation of NAFTA until 2005, Mexico was the dominant foreign supplier of cotton apparel to the U.S. market. However, since peaking in 2000, Mexican shipments are off 38%, and 2006 shipments are forecast to slide 15.8% from 2005 levels. A key reason for the decline is a unit

cost well above both the world average and the average costs from several key competitors. The average cost of Mexican cotton apparel shipped to the United States has ranged from \$4.30 to \$4.46 per square meter equivalent (SME) in each of the last seven years, while the world cost has gradually declined from \$3.64 to \$3.22. In recent years, Mexico has lost volume in the key categories of knit and woven shirts and bottoms (off 3.5%, 16.1%, and 19.2%, respectively, from 2005). Together, these three categories account for over 75% of Mexican apparel shipments to the United States. Higher production and labor costs relative to key competitors continue to hamper the competitiveness of Mexican apparel. The outlook for 2007 does not support a dramatic shift in these key factors, suggesting that the volume of Mexican imports may decline further.

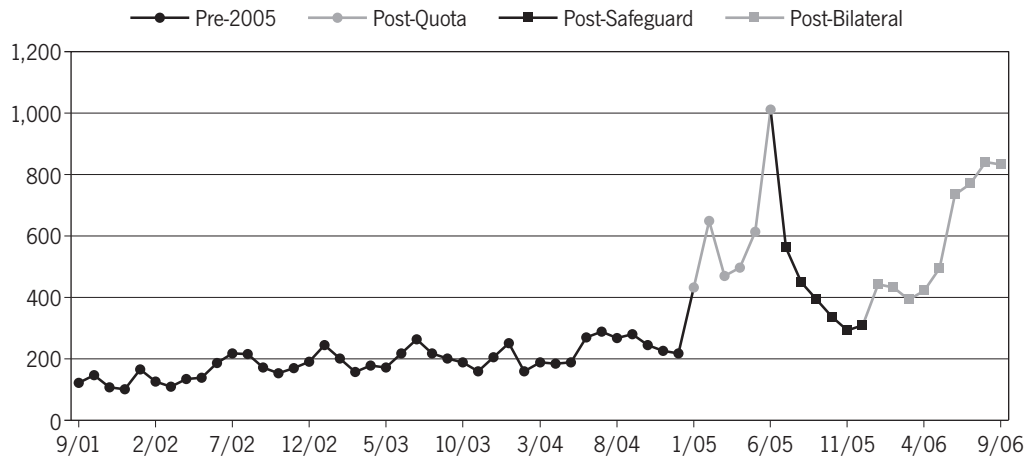
CAFTA-DR: Further Declines Ahead

The key Central American and Caribbean textile and apparel suppliers to the U.S. market—Costa Rica, Honduras, El Salvador, Nicaragua, Guatemala, and the Dominican Republic—similarly have seen declines in U.S. shipments in recent years. After peaking in 2004, import volume slid 3.9% in 2005 and is forecast to drop another 8.7% in 2006. Declines in several key cotton apparel products are behind the drop in volume from the CAFTA-DR nations. In particular, volume is down from 2005 in underwear (off 17.1%), bottomswear (off 21.0%), and woven shirts (off 7.0%), which together accounted for 55.1% of cotton apparel imports from the region.

Even though average CAFTA-DR costs are lower than those of other key suppliers, other factors have contributed to the recent decline in shipments, notably delays in implementation and interpretation of the trade agreement and concentration of CAFTA-DR suppliers on a few key products. The outlook for 2007 does not support a dra-

Chinese Cotton Apparel Shipments to the United States

Million US\$, Sept. 2002 to Sept. 2006

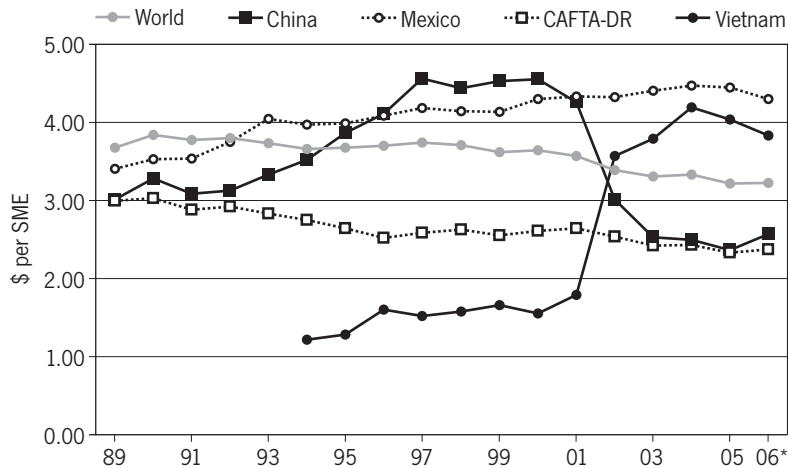


Source: U.S. Commerce Department.



Average Cost of Imported Cotton Apparel, by Supplier

1989 through 2006*



Source: U.S. Commerce Department. *Cotton Incorporated forecast.

matic shift in these factors, suggesting that CAFTA-DR import volume may decline further.

Vietnam: A New Dawn

Vietnamese cotton apparel shipments have climbed in recent years and are poised to expand further after 2006. Apparel imports from Vietnam are forecast to rise 30.2% in 2006, propelling it to the rank of seventh-largest foreign supplier to the United States, ahead of every CAFTA-DR supplier. Assum-

ing that Vietnam joins the WTO in the near term, becoming eligible for quota-free access to other WTO member nations, it could see a dramatic increase in shipments. Vietnamese shipments to the United States could grow faster than both total imports and retail apparel sales. As in the Chinese scenario, faster growth of supply than demand would suggest a return to price pressure on imports and retail price deflation in 2007.

The Bottom Line

Even with the retrenchment in aggregate demand across the wider economy, 2006 retail sales of cotton-dominant apparel are still poised to grow by over 5% from 2005, to a record level. Given the evidence and outlook for increased penetration by several key suppliers in 2007, import volumes may accelerate from the tepid growth witnessed this year. Deceleration in U.S. economic growth in recent months suggests limited opportunity for above-trend growth in apparel sales in the new year, suggesting that imports may again outpace retail sales growth and pointing to renewed price pressure throughout the supply chain.

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