



# Focus on Prices and Spending



## Import and Export Prices: Second Quarter 2011

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### Current Price Topics

## The Impact of Soaring Cotton Prices on Consumer Apparel Prices

In March 2011, the world price of cotton peaked at levels not seen in more than 140 years. Prices of cotton exports from the United States, the world's leading cotton exporter, surged nearly 300 percent in the 2-year period between March 2009 and March 2011. What caused these price hikes, unprecedented since the Reconstruction days following the Civil War? More importantly to the U.S. economy, what will be the ultimate impact on clothing and apparel prices for U.S. consumers?

Despite the fact that cotton is grown in 90 countries around the world, the industry is relatively concentrated, with the top three producers—China, India, and the United States—accounting for more than 60 percent of total world production and consumption.<sup>1</sup> Since the 1980s, the Chinese government has adopted various strategies to stimulate the cotton sector and increase productivity. China is now simultaneously the largest cotton producer and consumer in the world. The United States, by contrast, is the world's dominant cotton exporter and the third-largest producer after China and India. Last year, one-

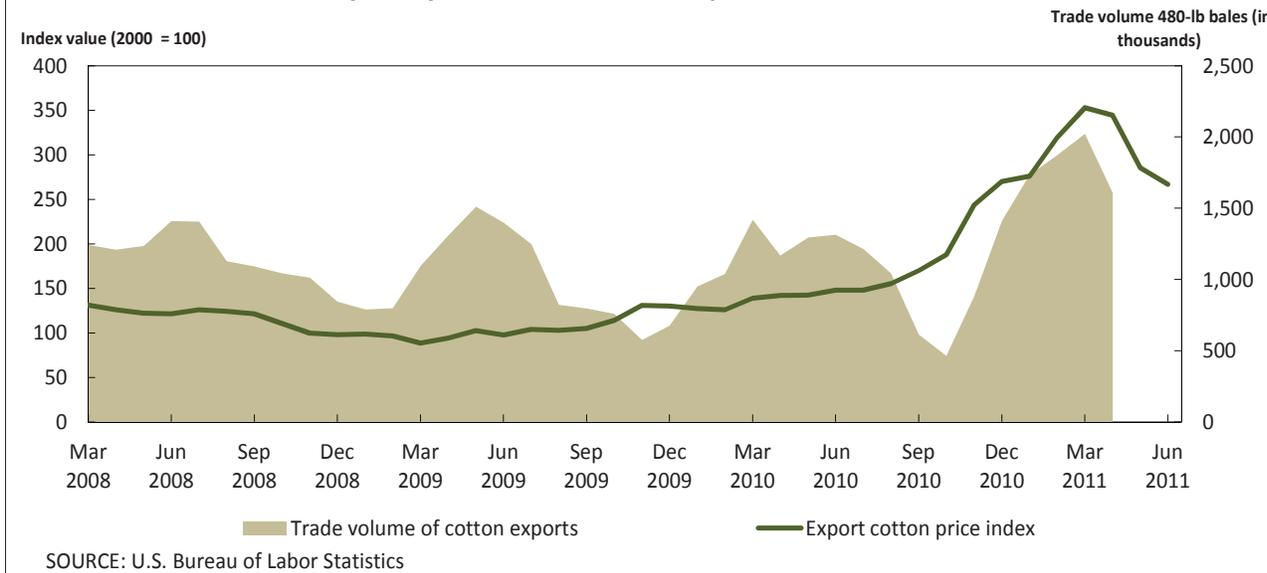
third of world exports were shipped from the United States. That number is projected to rise to nearly 42 percent for the 2010–11 crop year.<sup>2</sup> The United States is also the world's largest importer of apparel, with approximately 97 percent of its domestic sales supplied from abroad.<sup>3</sup>

### Export Cotton

The drastic price increases for cotton over the past 2 years were preceded by a significant decline. From March 2008 through March 2009, export cotton prices decreased 32.5 percent. (See chart 1.) The drop was due to the impact of the 2008 global economic and financial crisis on cotton consumption levels. Troubled by the possible effects of weak local demand on cotton growers, the Chinese and Indian governments increased their purchase of domestic stock by early 2009 in order to bolster price levels. Despite being the world's largest cotton producer, China consumed more cotton than it produced from 2009 to 2010, leading to an increase in its demand for exported U.S. cotton. In turn, U.S. exports exceeded production levels and the price trend changed course. From March 2009 to March 2010, export cotton prices increased 56.9 percent.

For the 2010–11 growing season, cotton shortages resulting from unfavorable weather conditions in Pakistan, China, and the United States ensured not only that prices continued

**Chart 1. U.S. cotton exports: price index and volume, March 2008–June 2011**

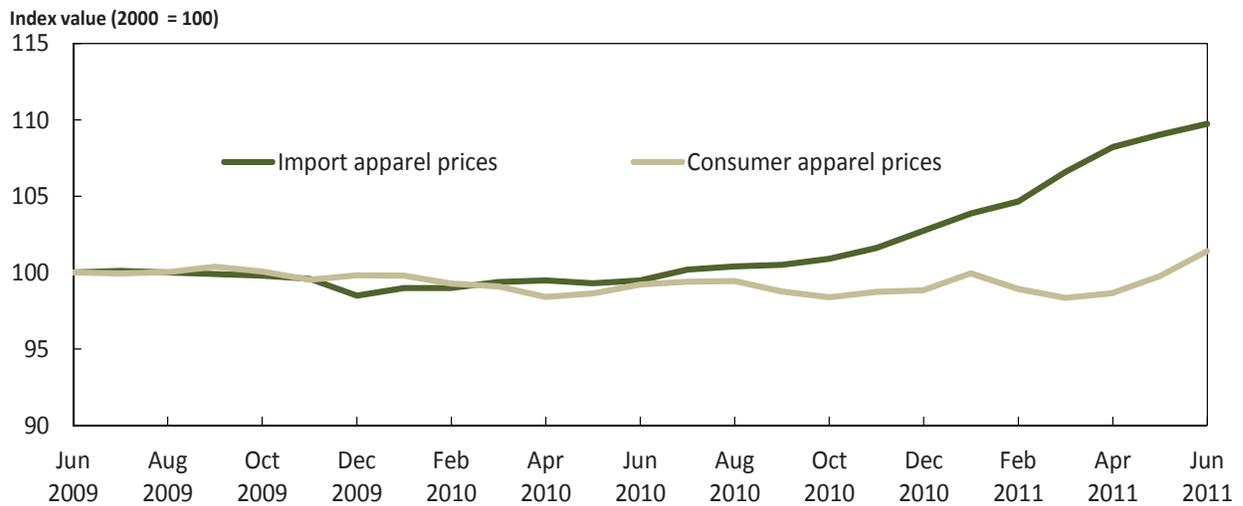


to rise, but that they did so to unprecedented levels. A continued ban on export cotton instituted by the Indian government in April 2010 caused the international supply to tighten even more. In addition, a weaker U.S. dollar, high prices for other agricultural commodities (which limit the land used for growing cotton), investor speculation, and increased postrecession consumption levels combined to push prices even higher. In the span of a year, from March 2010 to March 2011, export cotton prices grew at an average monthly rate of 8.1 percent and 153.8 percent overall. The sharp rise in U.S. cotton exports since September 2010 also has had the effect of reducing domestic inventories. The stock-to-use ratio fell to 12 percent for 2010–11, the lowest level since 1925.<sup>4</sup>

Recently, higher prices have affected the global market as demand has waned and prices have inched downward. Since peaking in March 2011, U.S. export cotton prices have decreased 24.3 percent. Export volumes also have dropped noticeably, due in part to severe drought conditions affecting the U.S. crop yield and to textile producers tapping into inventories rather than importing new supplies, in the hope that prices will fall further.<sup>5</sup>

The gradual recovery from the 2008 economic and financial crisis led to higher demand for import apparel, and subsequently import cotton apparel prices also rose, albeit less dramatically. Since December 2009, cotton apparel prices advanced 11.4 percent.

**Chart 2. U.S. cotton apparel import prices and seasonally adjusted consumer**



SOURCE: U.S. Bureau of Labor Statistics

(See chart 2.) In addition to the record-high cotton prices, other factors have contributed to the rising price of U.S. textile imports, including rising transportation costs, a stronger Chinese yuan, and increased labor costs in China.<sup>6</sup> There is now concern that these high prices for imported apparel could pass through to domestic apparel prices, thus directly affecting the U.S. consumer.

China is the dominant supplier of apparel to the United States. In 2010, China provided up to 40 percent of total U.S. apparel imports and 33 percent of total cotton apparel imports.<sup>7</sup> Although domestic apparel retailers try to avoid passing the rising cost of raw materials directly to the consumer, pressure

has mounted from several sources, making it harder for retailers to continue to absorb increasing costs. One of these sources is China's increasingly competitive labor market, which has led workers to demand better pay. Labor accounts for more than 20 percent of the total cost in textile manufacturing. Also, higher salaries in China have led to increased domestic demand, which in turn has contributed to a runup in prices. Meanwhile, U.S. retailers have been switching to pieces with a greater blend of fabrics, thereby reducing the effect of cotton prices on apparel. However, the greater demand for other natural and artificial fibers, polyester in particular, has forced prices to rise in those industries as well.

All this has implications for the U.S. consumer market. Current projections by the American Apparel and Footwear Association point to upcoming hikes in domestic prices for fall 2011.<sup>8</sup> At the same time, the seasonally adjusted Consumer Price Index (CPI) for apparel less footwear rose 2.2 percent in the 12-month period through June 2011. Historically, there has been a lag in the effect of higher import prices on domestic markets, and in the case of apparel the pass-through effect is very often averted. However, consumer apparel prices have been on the rise over the past 3 months, and they bear watching in the near future.

### Current Price Trends

## Quarterly Price Highlights

### Import Prices

During the second quarter of 2011, import prices increased 2.1 percent, after rising 6.3 percent during the first quarter of the year. The second-quarter increase was driven by a 5.1-percent advance in prices for fuels and lubricants. The price index for nonfuel imports also contributed to the rise in import prices, advancing 1.0 percent during the second quarter of the year.

### Fuel Import Prices

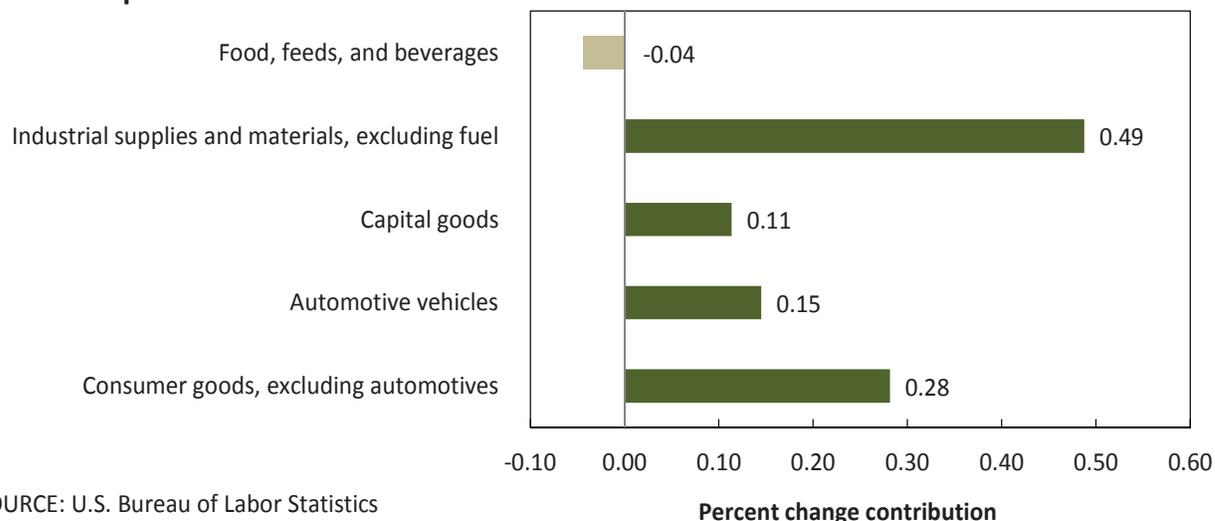
During the second quarter of 2011, prices for fuel imports rose 5.1 percent, the smallest

increase since the third quarter of 2010, when prices rose 0.5 percent. The quarterly increase was the result of a 7.6-percent advance in fuel import prices during the month of April. For the months of May and June, prices declined 0.8 percent and 1.6 percent, respectively.

Petroleum prices rose 8.1 percent in April, a large enough increase to drive fuel import prices up for the quarter, despite subsequently declining 0.9 percent in May and 1.6 percent in June. Continued political unrest in the Middle East, especially in OPEC member nation Libya, was a major contributor to the rise in petroleum prices. Fighting in Libya intensified in April, with the forces of Muammar Gaddafi and the antigovernment opposition fighting for control of strategic oil fields around the city of Berga.<sup>9</sup> Signs of an economic recovery in the United States also contributed to the rise in the price of petroleum in April. News that the unemployment rate dropped and that the economy added more than 200,000 new jobs bolstered the sentiment that crude demand prices would start to rise.<sup>10</sup>

May and June brought declines in petroleum prices. Although political unrest in the Middle East was still an issue of concern in May, it was trumped by a rise in U.S gasoline stocks and a strengthening of the U.S dollar. Both factors brought about a decline in petroleum prices, the first since the third quarter of 2010. In June, the United States and 27 other countries released 60 million barrels of oil from their

**Chart 3. Major contributors to the 1.0-percent increase in import prices, excluding fuel, second quarter 2011**



SOURCE: U.S. Bureau of Labor Statistics

NOTE: Due to rounding, figures do not add to total.

reserves in an attempt to offset the disruption of oil supplies from Libya.<sup>11</sup> Coupled with rising concerns about European debt, the result was a decline in petroleum prices for a second straight month. Natural gas fell 0.3 percent during the second quarter of 2011.

### Nonfuel Import Prices

The price index for nonfuel imports rose 1.0 percent during the second quarter of 2011, the ninth consecutive quarter the index increased. As illustrated in Chart 3, rising prices for industrial supplies and materials, excluding fuel, and for consumer goods were the major contributors to the overall increase in nonfuel prices. Rising prices for automo-

tive vehicles, as well as for capital goods, had a less significant impact, although they did contribute to the overall increase, while prices for foods, feeds, and beverages declined for the quarter.

Prices for industrial supplies and materials, excluding fuels, increased 2.8 percent in the second quarter of 2011. Higher prices for plastic materials, nonmonetary gold, and precious metals, which rose 9.6 percent, 9.9 percent, and 6.1 percent, respectively, led the advance for the quarter. With a large amount of economic uncertainty, gold and other precious metals have become an attractive refuge for investors.<sup>12</sup> Plastic materials prices had been driven up by higher petroleum prices in

previous months.

In the second quarter of 2011, the price index for consumer goods, excluding automotives, advanced 0.9 percent, the largest increase since a similar 0.9-percent advance in the second quarter of 2008. As mentioned in the first section of this report, cotton prices have had a significant impact on the index. Prices for cotton apparel increased 2.8 percent during the quarter.

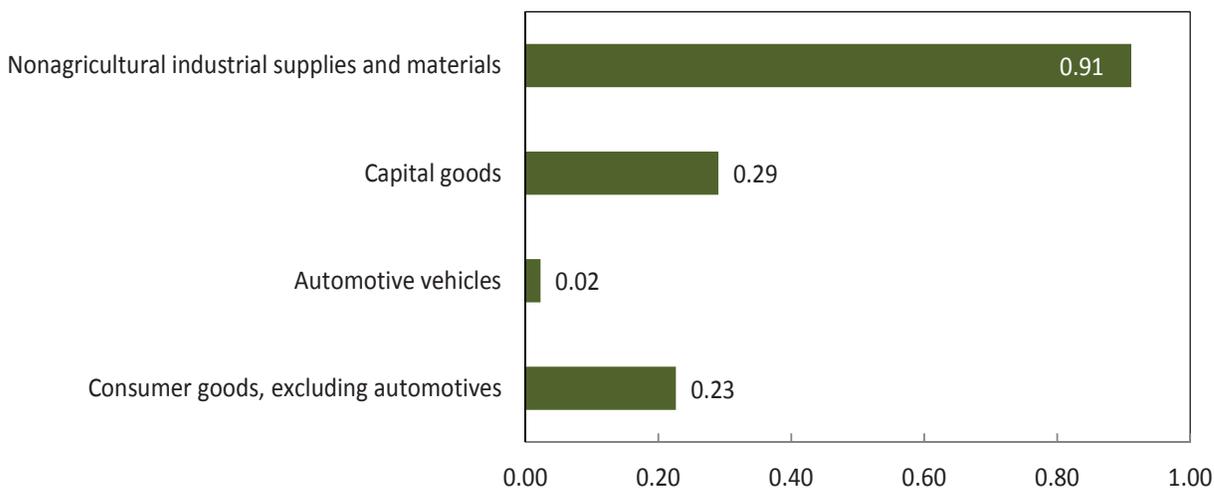
The price index for foods, feeds, and beverages decreased 0.6 percent in the second quarter, despite having increased 2.0 percent in April. The quarterly decline was the first since the index fell 3.7 percent during the first quar-

ter of 2009. Falling prices for vegetables were the primary catalyst for the index's decline. The commencement of the growing season in the United States brought about a decline in prices as greater quantities of vegetables became available on the market. Prices for automotive vehicles, parts, and engines rose 1.1 percent, the largest quarterly increase since a similar 1.1-percent advance in the second quarter of 1995. The price index for capital goods rose 0.6 percent.

### Export Prices

The overall export price index rose 1.2 percent during the second quarter of 2011, following a 4.1-percent increase during the previous

**Chart 4. Major contributors to the 1.5-percent increase in export prices**



SOURCE: U.S. Bureau of Labor Statistics

NOTE: Due to rounding, figures do not add to total.

quarter. The most recent advance marked the ninth consecutive quarter that export prices rose. Prices for nonagricultural exports increased 1.5 percent in the second quarter, while prices for agricultural commodities had a mitigating impact on the movement of overall exports, declining 0.9 percent.

### **Agricultural Export Prices**

The second-quarter decline in agricultural prices was the result of decreases in a wide range of product prices in May. As a whole, prices fell 2.0 percent during the month. One of the most significant contributors was the price of cotton. Prices fell sharply, declining 24.3 percent in the second quarter. Higher grain prices in the second quarter offset the falling cotton prices somewhat, although the advances were small compared with those of the previous 12 months. Corn prices rose 4.8 percent after increasing 76.6 percent over the previous 12 months, soybean prices advanced 0.8 percent for the quarter following a 43.0-percent rise over the March 2010–11 period, and wheat prices increased 1.8 percent after advancing 73.1 percent between March 2010 and March 2011.

### **Nonagricultural Export Prices**

The price index for nonagricultural exports increased 1.5 percent in the second quarter of 2011, the ninth consecutive quarterly increase. As can be seen in chart 4, the index

was driven up primarily by rising prices for nonagricultural industrial supplies and materials, which advanced 2.4 percent in the second quarter. Higher prices for capital goods and consumer goods, also contributed to the increase, although their impact was much less significant. Although the price index for automotive vehicles increased, it was of such a minor amount as to have little impact on the price index for nonagricultural exports.

The increase in nonagricultural prices took place in the early part of the quarter, and by June prices declined. In April and May, the index increased 2.2 and 0.9 percent, respectively. A wide range of commodities was responsible, as prices for fuel oil, plastic materials, steel mill products, and gold all rose. Falling prices for fuel oil, plastics, and natural gas in the month of June had a mitigating impact.

Capital goods prices rose 0.6 percent over the same period, after ticking up 0.1 percent during the first quarter of 2011. The second-quarter increase was the largest since the index rose 0.8 percent in the second quarter of 2008. A wide range of items recorded price advances during the first 2 months of the quarter, attributable largely to rising costs for materials. The price index for consumer goods rose 1.9 percent in the second quarter of 2011, the largest gain since a similar advance of 1.9 percent in the first quarter of 1988. Driving up the index were higher prices for jew-

elry, gem stones, and textile apparel.

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## Notes

<sup>1</sup> The United Nations Conference on Trade and Development estimates that cotton was grown in 90 countries in 2007.

<sup>2</sup> “U.S. Cotton Market Monthly Economic Letter—July 13, 2011,” Cotton Incorporated, <http://www.cottoninc.com/MarketInformation/MonthlyEconomicLetter/#top>.

<sup>3</sup> The figure is from 2008. (See American Apparel and Footwear Association, <https://www.apparelandfootwear.org>.)

<sup>4</sup> U.S. Department of Agriculture: *Cotton: World Market and Trade Archives*, [http://www.fas.usda.gov/cotton/circular/2010/November/cotton\\_full11-09.pdf](http://www.fas.usda.gov/cotton/circular/2010/November/cotton_full11-09.pdf).

<sup>5</sup> U.S. Department of Agriculture: *Cotton: World Market and Trade*, July 12, 2011, <http://usda.mannlib.cornell.edu/usda/fas/cotton-market//2010s/2011/cotton-market-07-12-2011.pdf>.

<sup>6</sup> Jon Hilsenrath, Laurie Burkitt, and Elizabeth Holmes, “Change In China Hits U.S. Purse,” *The Wall Street Journal*, Tuesday, June 21, 2011.

<sup>7</sup> Department of Commerce, International Trade Administration, “*Major Shippers Report*, U.S. General Imports by Country” July 11, 2011, <http://otexa.ita.doc.gov/msrcty/a5700.htm>.

<sup>8</sup> Hilsenrath, Burkitt, and Holmes, “Change In China.”

<sup>9</sup> See “Oil Prices Hit Highest Level Since 2008,” *The Sydney Morning Herald*, Apr. 8, 2011.

<sup>10</sup> See “Oil Rises to Above \$108 as US Jobs Market Improves,” The Associated Press, Apr. 4, 2011.

<sup>11</sup> See “Oil Prices Plunge After U.S., Allies Announce Release of Reserves,” *The Washington Post*, June 23, 2011.

<sup>12</sup> See “Precious Metals: Investors Seeking Refuge Boost Gold, Silver,” *The Wall Street Journal*, Apr. 8, 2011.