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Corn: Just how tight?

The November USDA crop report contained two very bullish items and drove corn prices to two-year highs (Chart 1).

US crop

Excellent spring planting conditions were marred by a dismal growing season. The August estimate called for a record corn yield of 181.8 bushels per acre (bpa). That was the peak, and the yield forecast has been in decline since. The average of analysts' guesstimates for November was 177.7 bpa, but the figure came in at 175.8 bpa. That in itself was good for a 215-million-bushel (5.46 million tonnes) haircut from the October production estimate.

Exports

US export commitments for corn (shipped and unshipped) stand at 35.3 million tonnes. That compares with a rather lame 13.3 million tonnes at this time last year, mostly on account of unprecedented Chinese purchases. To date, Chinese importers have contracted to buy 10.948 million tonnes, compared with 60,800 tonnes last year at this time.

As a result of this new phenomenon, the USDA keeps raising its total-annual-sales estimate for the 2020-21 marketing year. The November crop report revised its export estimate to 67.1 million tonnes, up from the 59.06-million-tonne October estimate, which would smash all previous records if achieved.

Perhaps these fantastic forecasts are somewhat premature. While China continues to have a presence in the market, Chinese purchases since October 1 have been just under one million tonnes. That is still far more than China normally buys in an entire season, as illustrated above, but it may also mean that the exuberance surrounding China may have overshot to some degree. After all, despite a disappointing crop, Chinese ending stocks are still estimated by the USDA at 191.5 million tonnes, or 68% of consumption.

With the crop and export revisions, the estimate for US ending stocks falls to 11% of usage, well below the average of the past several years of about 14.5%. Headed towards bull market territory? When compared with other eras that saw stocks fall to as low as 7% of consumption, we're not there yet.

With the US crop made, the supply situation is not going to change very much. It will come down to the sustainability of Chinese buying.

Another important issue is South American output. Planting weather in Brazil has not been ideal. The USDA, however, maintained its forecast for a record crop of 110 million tonnes, up from 102 million tonnes in 2019- 20. It is a bit early to worry about South American weather. More significantly, even if the crop does not reach optimum levels, bear in mind that both Brazil and Argentina grow about 25% more corn than they did just a few years ago. As amply illustrated by the soybean market during the height of the trade war, the US is no longer the only country that can meet the demands of world agricultural trade.

US ethanol usage was estimated at 5.05 billion bushels (128 million tonnes), which represents a 4% recovery from the 2019-20 marketing year, which included the worst moments of the pandemic. That would still be 6% below the pre-pandemic 2018-19 season. With Covid-19 vaccines on the horizon, it would be nice to believe that personal and commercial driving patterns will return to normal.

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However, corn-based ethanol accounted for about one-third of corn demand before the pandemic hit. A significant miss on this forecast would mean that US ending-stock estimates would be revised higher.

In conclusion, the possibility exists that the bullish infusion of Chinese imports was a passing phase, fueled in part by the need to fulfill the agreement with the US signed in January. Ethanol demand might be overstated. If so, despite the poor showing of the US crop, supplies are hardly tight.

We remain short March corn, as per our October 15 recommendation. Our $4.35-per-bushel stop close – while uncomfortably close – was not triggered.

[By Sholom Sanik, November 19, 2020]

Chart 1 – CBOT weekly nearest contract corn



Chart courtesy Reuters

COTTON

Can demand keep up with output?

Cotton prices plunged when news of Covid-19 first emerged but have been rallying since (Chart 2). Weather issues with the US crop made headlines, but with the harvest almost complete, it seems that crop pulled through in fine condition. In fact, the November USDA crop report once again revised the pound-per-acre yield upward to a record 911 pounds. Output will be smaller than the previous two seasons, but only because farmers planted fewer acres.

The main driver of the rally was the return of Chinese imports after the US and China signed an agreement back in January. Cotton was one of the commodities that was slapped with a 25% import tariff by the Chinese government during the US-China trade war. Marketing-year-to-date for 2020-21, export commitments to China stand at 3.39 million bales, compared with 1.83 and 1.49 million bales in 2019-20 and 2018-19, respectively.

Overall, though, US exports are lagging. As of the most recent weekly USDA export report, total commitments to all destinations are 9.2 million bales, down from 10.2 million bales last year at this time. Without more Chinese purchases, which could run dry after the fulfilments to the US-China trade agreement are met, the global commitment tally speaks more to sluggish demand. In fact, since October 1, China has purchased only 203,000 bales from the US.

It is a bit of a challenge to explain why cotton prices have been quite so strong. Looking at the new crops, among major producers, only the US planted a smaller crop. For the other two major producers, India and China, output is expected to be slightly larger than in 2019-20.

The big drag on this market should prove to be the production/consumption deficit left over from the 2019-20 marketing year. Production was 122 million bales pitted against consumption of 102 million bales. Global ending stocks jumped to 99.59 million bales, just shy of 100% of usage. That compares with 66.8% at the end of 2018-19. Everything that was accomplished by the Chinese government's selling off stocks from state reserves is basically out the window.

As with many markets, the hope of a return to normal commerce with the introduction of Covid-19 vaccines over the next year has inspired buying. But even with a recovery in retail clothing sales, the burdensome stockpile of cotton that accumulated over the past nine months could easily accommodate the demand.

When we last discussed cotton (see *Focus on Futures*, August 31), we presented the St. Louis Fed's retail clothing and clothing accessory monitor. After a sharp recovery from the darkest days of the pandemic's shutdown, retail clothing sales seem to be settling into a new level that is

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still well shy of pre-pandemic norms (Chart 3). Realistically, with brick-and-mortar chains closing stores en-masse, it may be some time before we see the kind of clothing demand that will eat into cotton inventories that hang over the market.

We believe that commodity funds are going to be trapped in their huge net-long position (Chart 4) and that a liquidation will ensue. The mostly bearish supply/demand fundamentals should assert themselves sooner or later.

We were stopped out of our short position in December cotton at 71¢ per pound as per our August 31 recommendation. Reestablish short positions in March cotton, currently trading at about 71.50¢. Place initial stops at 75¢, close only.

[By Sholom Sanik, November 20, 2020]

Chart 2 – ICE march cotton



Chart courtesy Reuters

Chart 3 – US advance retail sales: clothing and clothing accessories stores

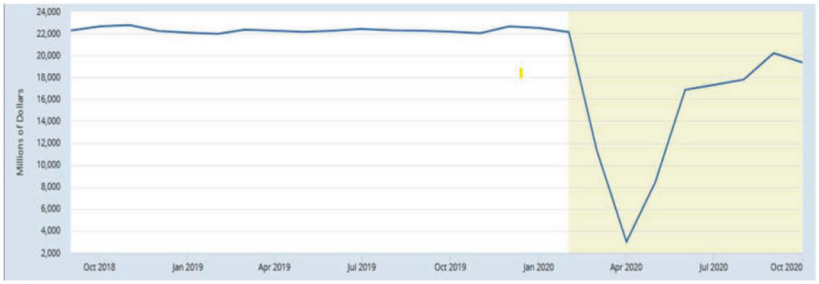


Chart courtesy St. Louis Fed

Chart 4 – CFTC commodity fund net-long position

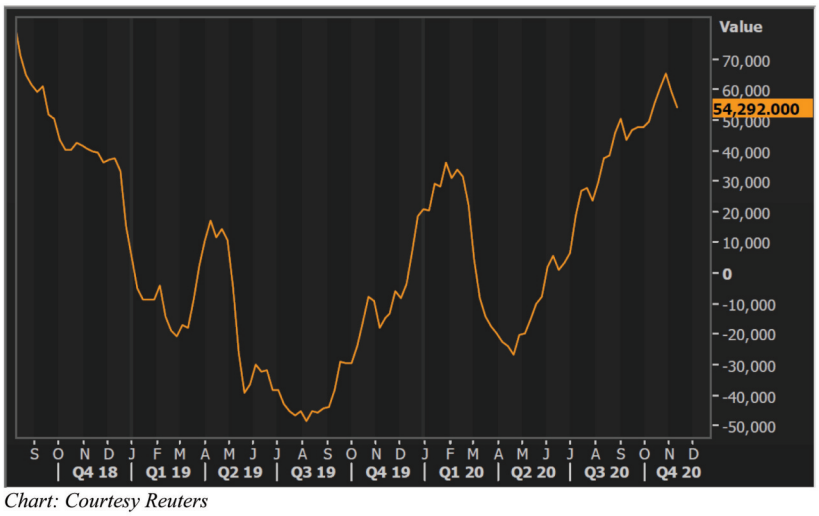


Chart: Courtesy Reuters

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SUGAR

Is the rally over?

Sugar prices peaked in mid-November (Chart 5). There have been no material changes in the supply/demand fundamentals, and we continue to believe that it is an overpriced market.

Brazil

As recently as early November, sugar mills in Brazil were still crushing close to 47% of the cane crop into sugar. That compares with 36% in recent years. Over the past few weeks, ethanol output has increased, with mills allocating only about 35% of cane to sugar. But it will not matter much. It's the tail-end of the season, and there is not much activity. More than half the mills in the principal growing region, the Centre South, have ceased operations for the season. Output estimates for the outgoing 2020-21 marketing year have actually risen to their highest level of the season, with one estimate at 41.8 million tonnes. The previous high was 41 million tonnes. That's about 40% higher than in 2019-20.

Analysts say that yields will be lower for the 2021-22 crushing season, which begins in April, because of dry weather. It is quite early, though, and that could change.

The greatest concern for bears should be the future of ethanol demand. The poignant issue will be how long it will take for petroleum usage to return to pre-Covid levels in Brazil. Brazil has the world's second highest Covid-related fatalities. Vaccinations are expected to begin in March, with 30% to 40% of the population receiving the treatment by mid-year. The sustainability of the ethanol/sugar ratio at these low levels is not realistic once the Brazilian economy returns to normal. However, as illustrated, we could be many months away from achieving a return to a fully functioning economy.

India

The 2020-21 Indian crushing season is getting underway, and output is anticipated to jump sharply, from 26.5 million tonnes in 2019-20, to 31 million tonnes. Carryover stocks at the end of 2019-20 are estimated at 10 million tonnes. Looking forward, with domestic consumption at about 26 million tonnes, inventories will rise to a record 15 million tonnes by the end of the season.

For the 2019-20 marketing year, the government provided export subsidies for 6 million tonnes of sugar, almost all of which was used. After keeping traders guessing, the government finally announced that the program will be repeated for 2020-21. Two consecutive years of Thai crop failures has tightened the Asian market. Another flood of Indian exports should alleviate any existing tightness.

Chart 6 shows the commodity fund net-long position, and it speaks for itself. Any liquidation could easily prick the bubble of this market that rose against a backdrop of bearish fundamentals.

Maintain long positions in March 13¢ puts, as per our September 25 recommendation. For new positions, buy May 13¢ puts, currently trading at about 40 ticks.

[By Sholom Sanik, December 16, 2020]

Chart 5 – ICE March sugar



Chart: Courtesy Reuters

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Chart 6 – CFTC commodity fund net-long position

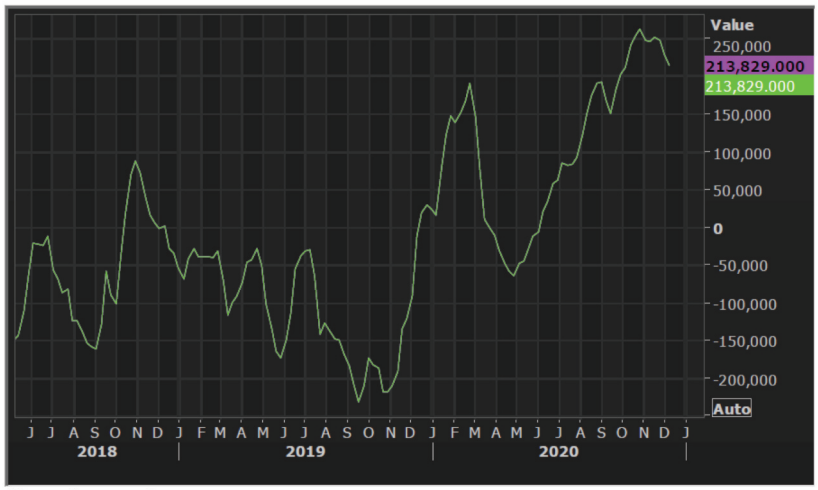


Chart: Courtesy Reuters

SOYBEANS

Are Chinese imports ebbing?

In the strategy section of our November 12 article on soybeans, "Chinese soybean buying leaves the cupboard bare," we stated: "While, as illustrated, the fundamentals are very bullish, we do not wish to chase …." Rather than tucking admission of this unfortunate decision back into the strategy section, we begin with it. March soybeans have since rallied $1.25 per bushel (Chart 7).

Just about every aspect of this market, on both the supply and demand sides, has been bullish.

US domestic consumption and foreign sales are on course to set records. The estimate for the US crush was revised upwards in the December USDA crop report, to 2.195 billion bushels (5.97 million tonnes), 1.4% higher than last year. The forecast for exports was maintained at a record 2.2 billion bushels (5.98 million tonnes), 14.7% above 2019-20.

And it's not just about China. At present, export commitments to China comprise 58.7% of total commitments. In the 2017-18 marketing year, which pre-dated the trade war, exports to China were 60% of the total. So, while it may seem that it's been all about China, the demand is broad based.

In fact, China may have had its fill for the moment. Chart 8 shows that the size of weekly Chinese commitments was indeed far larger than average, but peaked near the beginning of the marketing year in September. After the Chinese bought what they needed to compensate for their absence during the height of the trade war and met their obligations to the agreement signed with the US back in January, the market has normalized.

The incoming administration has indicated that there are no plans to drop tariffs imposed on China, which means that the Chinese will not eliminate their import tariffs either. We believe that this could mean that once South American supplies become available in the spring, we could be back to square one.

Total US export commitments stand at 54.15 million tonnes. Assuming that we do not see cancellations, and with eight months remaining in the marketing year, we are still in pretty good shape to meet the USDA's target for annual sales to all destinations of a record 59.87 million tonnes. However, we do not expect China to carry the bullish torch indefinitely.

The other story that has provided fuel for this powerful rally is South American weather. Both Brazil and Argentina have seen dry conditions, which has sparked downward revisions for 2021-22 crops. The USDA has maintained its 133-million-tonne forecast for Brazil, but a recent local estimate puts the crop at 127 million tonnes.

With the revisions in the December crop report, the USDA puts 2020-21 US ending stocks at 175 million bushels (4.76 million tonnes), or 3.8% of consumption. That's a record low and means that the US will all but run out of soybeans by the end of the season. The focus will therefore soon turn to what we can expect in terms of new supplies in the fall of 2021.

Early projections call for 89 million soybean acres to be planted this spring. That compares with 83.1 million acres planted for the 2019-20 crop. With normal weather and demand remaining constant, a rough calculation would translate into a jump in 2021-22 ending stocks to 500 million bushels (13.6 million tonnes) and back to 12% of usage.

Chart 9 shows that new-crop (November 2021) soybeans have been outperforming new-crop corn (December

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2021) by a wide margin, which makes planting soybeans far more profitable than planting corn. If the rally in beans holds up through planting season, the soybean acreage estimate could be accurate.

Commodity funds have poured into the long side in droves. In fact, the net-long position is as large as it was when soybean prices spiked to $17 per bushel in 2012 (Chart 10). It is tempting to join the crowd. We believe, however, that while this bull run has a solid footing in supply and demand fundamentals, history also shows that bull markets eventually bring unexpected large output to the market, in addition to eventually reaching a level at which demand begins to dissipate – as evidenced by dwindling Chinese imports.

Remain sidelined.

[By Sholom Sanik, December 24, 2020]

Chart 7 – CBOT March soybeans



Chart: Courtesy Reuters

Chart 8 – Weekly Chinese US purchases (1,000s of tonnes)

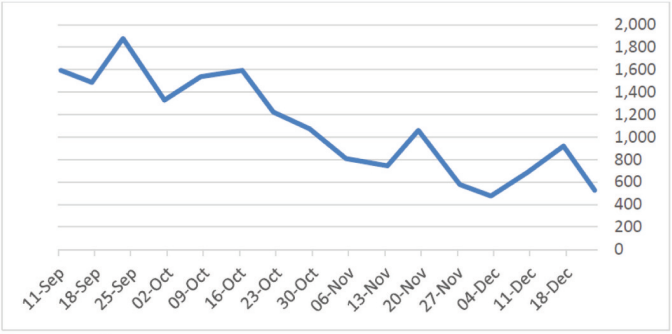


Chart source: Reuters

Chart 9 – November 2021 soybeans/December 2021 corn



Chart: Courtesy Reuters

Chart 10 – CFTC commodity fund net-long position

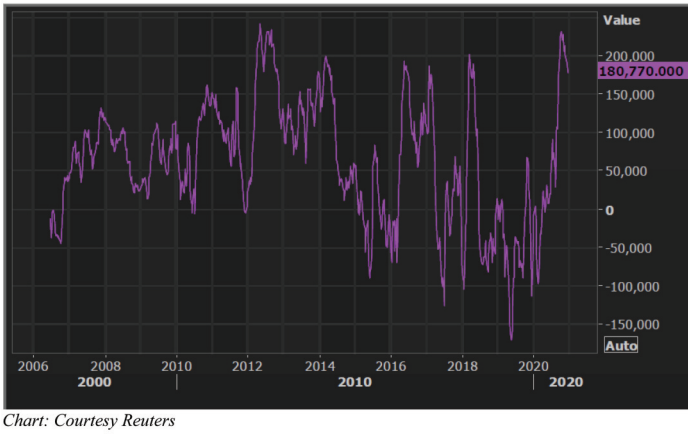


Chart: Courtesy Reuters

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