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Coffee: Aging bull?

The late-November commodity thrashing that was set off by the omicron scare left no stone unturned. Coffee prices had notched a new high for this bull market just a couple of days earlier, but plunged by about 15¢ per pound in just one session. Market action since has been strange. In the subsequent sessions, coffee shook off omicron and set yet another high for the move, only to lose steam and dip to below the "omicron" lows (Chart 1).

The demand-side fundamental issue would be the possibility of coffee shop and restaurant closings. Even during the darkest days of the pandemic, at-home consumption was not affected, but global demand slipped by about 1.5%, mainly because of the shuttering of Starbucks et al during the period. That remains a risk for consumption, but at the moment, governments, at least in the US, do not seem to be headed in that direction.

Which turns us to the primary issue, the supply side: The size of the 2021-22 Brazilian arabica crop, now that analysts have had a chance to assess the damage that resulted from the July 2021 frosts and estimates of damage to trees that will carry the 2022-23 crop, is going to be the issue going forward.

Total Brazilian output for 2020-21 reached a record 70 million bags. Arabica beans comprised about 50 million bags of the total, and the balance was robusta. Estimates for the damage to the 2021-22 arabica and robusta crops vary widely. For arabica, the low end is 31.4 million bags with a high end of 42 million bags. For robusta, some analysts see very little fallout with other estimates as low as 16.5 million bags.

Regarding the damage done to trees in trying to forecast 2022-23 output – well, if there is so much uncertainty surrounding the crop that is growing, one can only imagine how inaccurate forecasts would be regarding the new crop.

In any case, dealing with what we do know, in the years before this drought-and-frost-compromised season, production growth was robust. Consumption grew as well, but was outpaced by output. According to the USDA's *Coffee: World Market's and Trade*, released earlier this month, in 2019-20 and 2020-21, the global production/consumption surplus was 6.8 million bags and 12.5 million bags, respectively. For 2021-22, depending on which crop estimate turns out to be accurate, at best there will be a small surplus, and at worst, there will be a several-million-tonne deficit. Either way, the market is left vulnerable to consumption trends, and most importantly, how the 2022-23 Brazilian crop will fare.

We have reached a one-year anniversary of our long coffee position, having first established a long position on December 29, 2020 (see *Focus on Futures*, December 29, 2020). On August 2 we raised the sell stop to $1.70 per pound. We now advise moving protective sell stops to $2.10, basis March, close only.

[By Sholom Sanik, December 29, 2021]

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Chart 1 – ICI March coffee

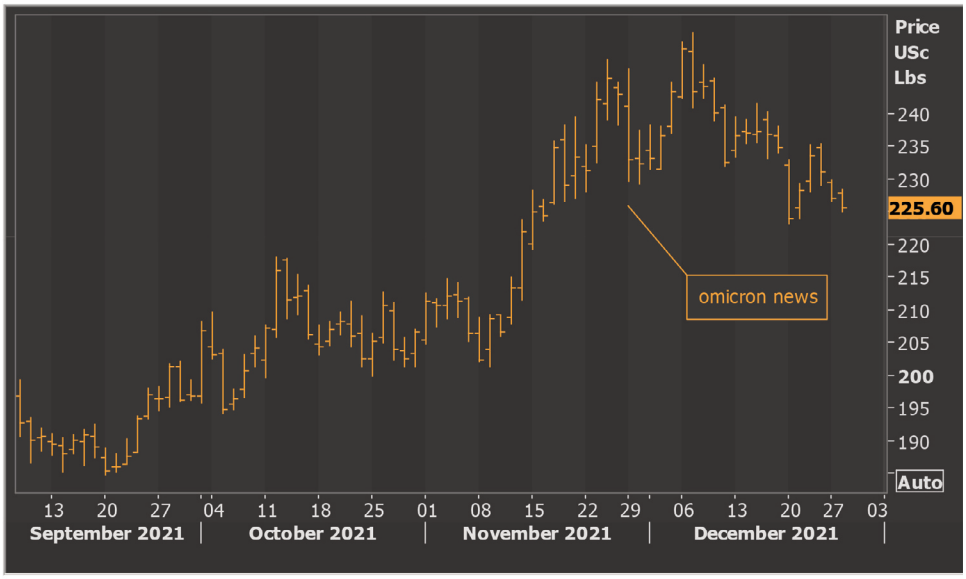


Chart courtesy Reuters

COCOA

Ghana holds the cards

After producing record crops in the 2020-21 marketing year, West African producing nations were expected to experience an off year in 2021-22.

In the early going of the Ivory Coast's main-crop harvest, which began back in September, it certainly seemed that this was going to be the case. As recently as mid-December, 2021-22 port arrivals were running as much as 13% below the same period the previous season. Since then, however, the pace has picked up. As of the most recently reported data, port arrivals have reached 1.34 million tonnes, 1.5% ahead of last year at this time.

With the bulk of the main crop harvested and favorable weather on the horizon for the mid-crop, fears of sharply lower production seem to be unfounded.

Ghana, however, is a completely different story. After producing an off-the-charts crop in 2020-21 of 1.1 million tonnes, this season's output will actually be subpar. In recent years, Ghanaian output averaged about 850,000 tonnes. Reportedly, precipitation in the development stage of this year's pods between June and September was very poor. As a result, even the most optimistic estimates have put total production at 700,000 tonnes.

Crop progress information out of Ghana is not reported in a uniform and weekly format as it is for the Ivory Coast. We suspect that the bleak outlook is somewhat exaggerated and that the outlook will improve. Regardless, it is clear that with West African crops comprising 70% of world output, new supply will not reach the lofty levels we saw in 2020-21.

On the demand side, overall, fourth quarter grind results appeared fairly strong. The EU, Ivory Coast, and Asia were up just over 6%. Prices rallied by 10% while these data were crossing the wire throughout mid-January. The North American grind departed from the trend by showing a 1.2% contraction in the period. According to media reports, traders found this to be very bearish and accounted for the selloff that erased almost the entire January rally (Chart 2).

We found this to be rather strange because North America is the smallest grinding region among the four. One would think that its weak performance should therefore have been dwarfed by the strongest percentage gains we've seen for the other regions in quite some time.

A possible explanation for the bearish reaction to the North American grind is that while the EU and Asia numbers appeared strong, they were year-over-year comparisons with the fourth quarter of 2020 which were very weak. Once traders read behind the headlines, the negative North American grind only served to reinforce that demand actually remains sluggish.

According to the International Cocoa Organization, we are looking at a sizeable production/consumption surplus for

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the outgoing 2020-21 marketing year after a production bonanza in West Africa. Early estimates for 2021-22 are looking for a balanced market, which would be directly attributable to the drop in Ghanaian output. As mentioned, we are somewhat skeptical that Ghana could lose so much production from one year to the next. Progress in Ghana, or lack thereof, therefore becomes the single most important issue for this market. Either way, the risk of any tightness is small, and if Ghanian output drifts anywhere close to its trendline production pattern, we will see another surplus this year.

We are short cocoa at about $2,600 per tonne, as per our November 1 recommendation. We used a very generous stop of $2,850, basis March, which worked out well because it allowed us to survive the January rally. Remain short and lower the buy stop to $2,750, basis the nearby trading month.

[By Sholom Sanik, January 28, 2022]

Chart 2 – ICI May Cocoa

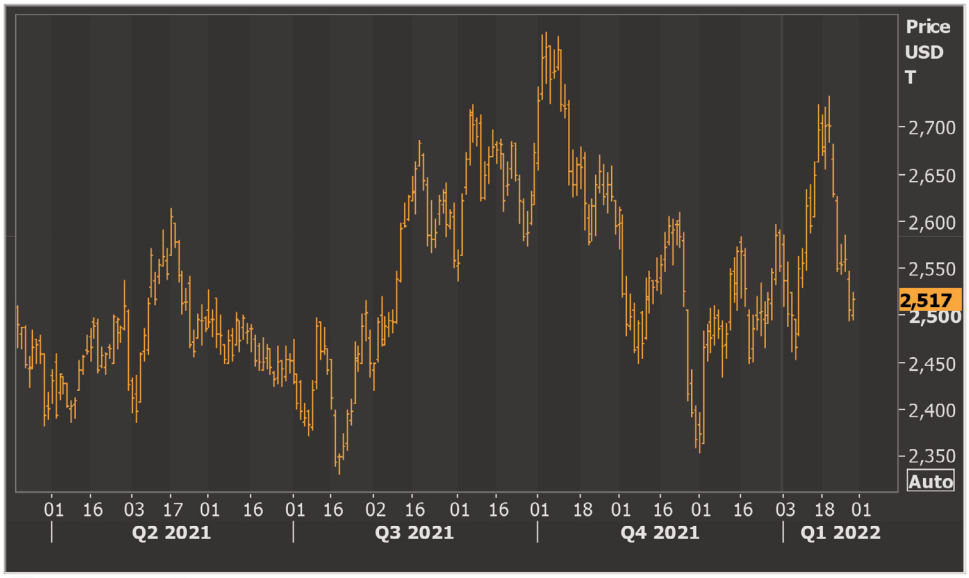


Chart courtesy Reuters

SOYBEANS

Soybeans aplenty

Soybean prices were already strong before the Russian invasion of Ukraine (Chart 3). The primary reason was dry conditions in South America. Before the weather deteriorated, the USDA estimate for the Brazilian 2021-22 crop was a record 144 million tonnes, up from 138 million tonnes in 2020-21. Then estimates began to drop to as low 122 million tonnes. In the March USDA crop report the estimate was revised lower by 7 million tonnes, to 127 million tonnes. Those dire forecasts, however, were followed by improved precipitation. Analysts who follow developments closely are assuming that crop estimates could continue to rise, and indeed, the latest round of updates showed some modest upticks.

Looking at the impact of the invasion, there were some contributing factors. News stories talked about Ukraine being the world's largest exporter of sunflower seed oil. True, but total global production amounts to only 10% of the global vegetable oil market. The Ukraine grows soybeans, but not many – 3.8 million tonnes, or about 1% of global production. The only tangible connection to the conflict would be an increase in soybean production costs for exporting countries, which will result from higher energy and fertilizer costs.

Disappointing South American output and some fallout from the conflict definitely carry some bullish weight. However, the USDA's March 31 US planting intentions forecast for the 2022-23 crop gave market participants some ground to question whether the soybean market can continue this bull run on these merits alone.

Whether the rally was warranted or not, high prices

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may inspire US farmers to plant a record number of soybean acres. In 2021-22 US soybean planted area was 87.2 million acres. Coming into the report, the average of analysts' guesstimates for the 2022-23 crop was 88.73 million acres. The actual figure came in at 90.95 million acres. If good weather delivers trendline yields, that's worth a jump of about 150 million bushels from the 2021-22 marketing year.

Now, this does not necessarily mean that ending stocks for 2022-23 will grow by a like amount. It all comes down to US exports.

In its March crop report, the USDA raised its estimate for 2021-22 US exports by 1 million tonnes, to 56.9 million tonnes. This reflects export commitments that have already reached 55.3 million tonnes with more than four months remaining in the marketing year. This sounds promising, but last year at this time commitments stood at 60 million tonnes, and final sales reached only 61.52 million tonnes by the end of the season because sales shift to South American origins from here on in. So we don't expect further large upward revisions.

Besides, total sales to China this marketing year (shipped and unshipped) stand at 28 million tonnes, compared with 36 million tonnes at this time last year. And there is not much evidence that China is going to return to last year's extraordinary import pace.

To illustrate, over the past two months, weekly new sales to China averaged 320,000 tonnes. That compares with 670,000 tonnes over the two previous months. So, while it seems that the USDA may have underestimated annual sales for 2021-22 to a degree, we do not believe that China can be counted on to pad the totals.

In conclusion, we cannot lump soybeans together with wheat and corn. Both Russia and Ukraine are major exporters of wheat, accounting for 19.2% and 8.3% of world trade in 2020-21, respectively. Ukrainian corn exports comprise 13.1% of world trade. The invasion effect simply does not exist for soybean output and exports as it does for wheat and corn.

Consequently, we believe that a large chunk of the soybean rally that brought prices close to multi-year record highs was perhaps overdone. The balance sheet for soybeans has not changed very much, and the increased production, if anything, will make supplies plentiful.

We recommend selling short July soybeans, currently trading around $16 per bushel. Place initial stops at $17.25, close only.

[By Sholom Sanik, April 7, 2022]

Chart 3 – CBOT July soybeans



Chart courtesy Reuters

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CORN

Ukrainian output in jeopardy

The 2021-22 Ukrainian corn crop, which was harvested last fall, reached a record 41.9 million tonnes. Before the invasion, exports were estimated at a record 32.5 million tonnes. But with shipping infrastructure compromised, USDA export estimates keep falling. In the April crop report, the export figure was revised down to 23.5 million tonnes, most of which was already sold abroad. One government agency estimates that about 15 million tonnes that were expected to be exported are in storage.

Obviously, there is no way of knowing when it will be shipped. In any case, that is not nearly the extent of the bullish case related to Ukraine. Far more pertinent is the prospect for the crop that will be available for the 2022-23 marketing year. Estimates vary, but the consensus is that planted area will shrink by about 35%. A quick end to the hostilities could see that forecast rise, but for the moment, that would seem to be overly optimistic.

US planting intentions

New-crop corn prices have outperformed new-crop soybean prices by a wide margin since Russia invaded Ukraine (Chart 4). As we illustrated in *Focus on Futures* (April 8), soybean output is not directly related to the conflict, but the impact on Ukrainian corn production and exports is front and center.

Yet the March 31 US planting intentions report for the 2022-23 crop was quite the surprise. Indeed, analysts expected that to show up in acreage allocation, but it did not. Soybean area was higher than expected (see *Focus on Futures*, April 8) while corn area was much lower than anticipated. The average of analysts' guesstimates was 92 million acres, but the actual figure came in at 89.5 million acres.

Prices have since rallied, but the rally has been somewhat muted, with prices still trading below levels reached in early-March after the initial reaction to the invasion.

Chinese imports

After racking up some impressive corn purchases from the US early in the 2021-22 marketing year, China has been largely absent from the market. Over the past couple of weeks, however, there were several Chinese purchases. US exporters reported 1.488 million tonnes of old-crop and 748,000 tonnes of new-crop sales.

It is fair to say that traders have lost confidence in the Chinese import factor after such a long absence since the mega purchases in 2020-21. A resurgence of Chinese buying would solidify this bull move. While the recent purchases were modest, it is interesting that there were any old-crop purchases at all. Perhaps it is an indication of improved demand.

The USDA estimate for the 2021-22 marketing year, which runs until August 31, is 63.5 million tonnes. Commitments to all destinations stand at 54.4 million tonnes. Aside from being well below last year's 66 million tonnes, the ratio of commitments to final sales is 85% compared with last year's 94%. So, unless China continues with a buying spree of old-crop, it is not likely that we are going to see upward revisions to exports.

In conclusion, between Ukraine, lower-than-expected US area for the new crop, and the *potential* for renewed interest from China, just about everything concerning this market is bullish.

In a manner of speaking, we stumbled into a long position because of growing ethanol production in the US back in April 2021. Questionable weather in South America and anticipation that the insatiable appetite for US corn that the Chinese displayed in 2020-21 would resurface kept the position alive. Then the Ukrainian crisis propelled the market beyond our expectations. Our $5.75-per-bushel sell stop for March corn suggested on December 22 came close to being triggered. Remain long July corn. Raise sell stops to $6.90, close only.

[By Sholom Sanik, April 12, 2022]

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Chart 4 – CBOT new-crop corn/soybean ratio



Chart courtesy Reuters

Chart 5 – CBOT July corn

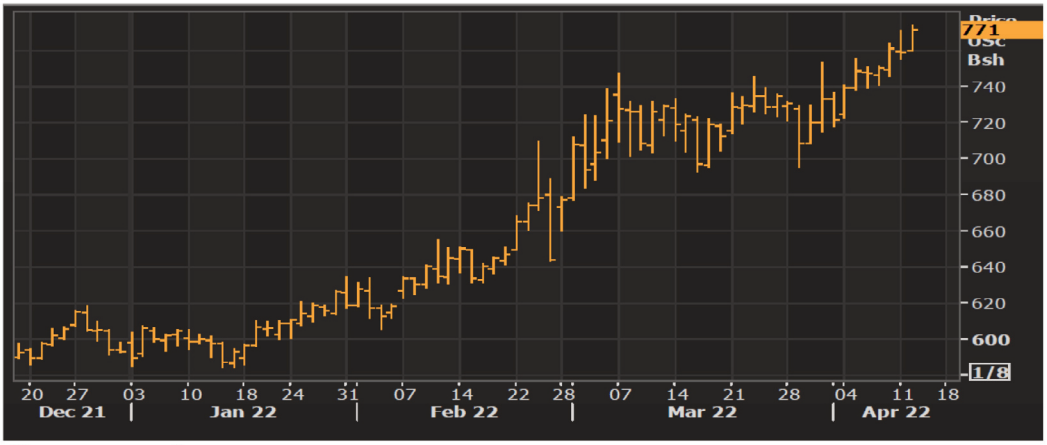


Chart courtesy Reuters

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