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Cotton: demand is creeping back

Cotton prices have been confined to a relatively tight range since the completion of the 2022-23 US harvest – with several trips to both the high and low ends of that range (Chart 1). Most recently, to the low end. There have not been any overt developments – bullish or bearish.

Demand

The biggest problem for US cotton prices this marketing year has been anemic exports. At the moment, export commitments stand at 10.4 million bales, down 17.7% from this time last year. The USDA estimates exports for the marketing year down 18%. Disappointing exports are "in the market," and any upside surprises should therefore be bullish. The most recent USDA export report showed weekly commitments to all destinations at 425,000 bales, the largest this season and the most cotton sold abroad in a single week since September 2021.

Focusing on China specifically, purchases from the US thus far in 2022-23 stand at only 2.2 million bales (shipped and unshipped), compared with 3.9 million bales at this time last year. Upon closer inspection, however, several silver linings pop up. First of all, while commitments are down sharply, at 1.57 million bales, shipments are about the same as last year's level, despite some hefty cancellations earlier in the season.

There is some evidence that imports are improving. Most of the Chinese buying was done in the early part of the marketing year. But since November, not only were they not buying, as mentioned above, there were some large cancellations, which are unusual so early in the season, as depicted in Chart 2. Over the past few weeks, however, Chinese purchases have been recovering.

Supply

Looking ahead to the supply side, the National Cotton Council reported its forecast for 2023-24 US cotton area at 11.46 million acres, down 2.3 million acres from 2022-23. This is not surprising, because farmers should favor soybeans over cotton. Chart 3 shows that the spot cotton/soybean price ratio is near the low end of the 10-year range. Some estimates for output are actually about the same as last year because analysts are assuming the devasting drought conditions will not be repeated. Only 54% of planted acres were harvested for the 2022-23 crop, dramatically below the historical norm. Weather must be on its best behavior.

A further vulnerability on the supply side comes from China. Early estimates for the 2023-24 crop call for a 3.7% decline in cotton area.

Pakistan

The February USDA crop report actually raised Pakistani output by 200,000 bales from the January estimate, but as a result of devastating flooding, production is still 35%

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below 2021-22. As we indicated previously (see *Focus on Futures*, September 28), Pakistani mills should be in the market for US cotton. Indeed, there is evidence of this. US exports to Pakistan (shipped and unshipped) stand at 1.63 million bales, 21% above last year. We're confident there is more to come.

We have been patient, waiting to see if demand would return, and we now believe that there is enough evidence that we are at the cusp of this transition. Buy December cotton, presently trading at 84¢ per pound. Place initial sell stops at 79.50, close only.

[By Sholom Sanik, January 18, 2023]

Chart 1 – ICE December cotton



Chart courtesy Reuters

Chart 2 – Weekly Chinese purchases from US ('000s of bales)

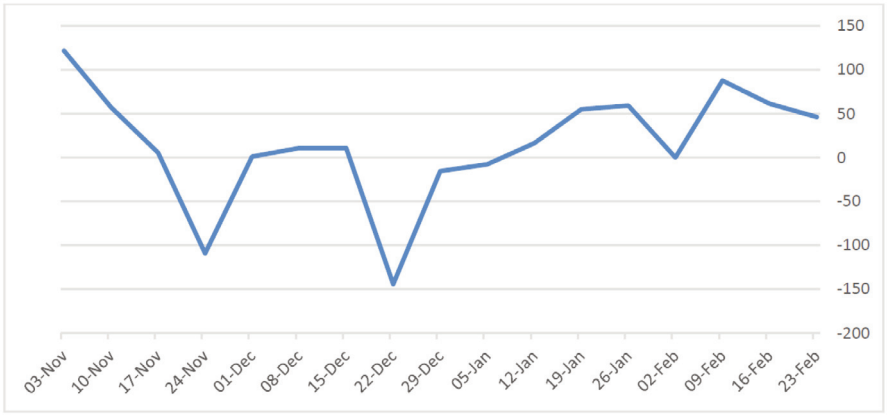


Chart source: Reuters

Chart 3 – Cotton/soybean ratio

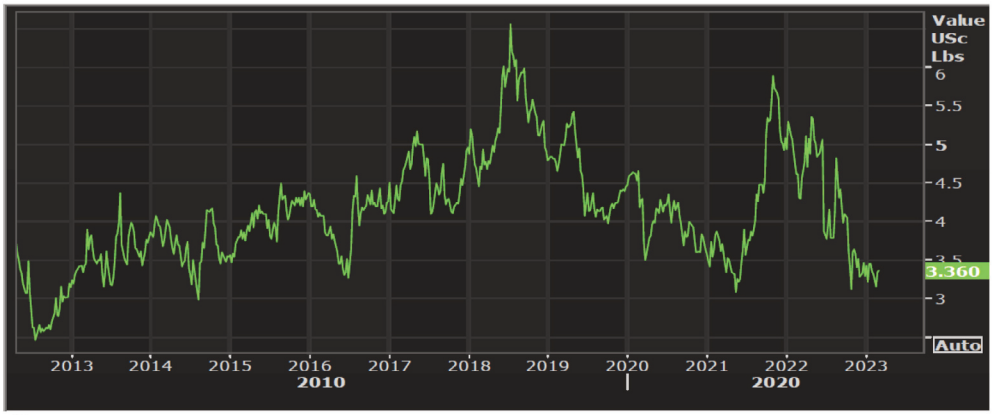


Chart courtesy Reuters

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SUGAR

Can India spoil the Brazilian bounty?

March sugar went off the board at 22.08¢ per pound, its highest price in six years (Chart 4). Meanwhile, analysts have been busy increasing Brazilian sugar production forecasts for the upcoming 2023-24 crush season. The cane crop is forecast to grow by 5.5% over 2022-23, to 588 million tonnes. Aside from a robust cane crop, anticipated diversion from ethanol production also accounts for the optimistic outlook. One estimate puts Centre South output as high as 38 million tonnes, up 5 million tonnes from 2022-23. Another analyst estimates the ethanol/sugar production ratio at 52/48. That would be down from about 60/40 in recent years and the most sugar produced in Brazil *vis-à-vis* ethanol in many years.

So why are sugar prices so strong?

First, what we're gaining in Brazil we are losing in India. In 2020-21 India exported about 11 million tonnes of sugar, close to double what was sold abroad in recent years. Up until several months ago, traders believed that this might become the new norm. The government, however, has made it abundantly clear that it would not allow domestic market supplies to be jeopardized, and as a result, it capped exports for 2022-23 at 6 million tonnes.

The Indian crush season for its 2022-23 marketing year begins in October, and sugar output estimates have been dropping. In 2021-22 production reached a record 37 million tonnes. The latest round of estimates for the current season put output at about 4 million tonnes lower. However, recent developments may render those estimates stale. The largest producing state, Maharashtra, which accounts for about 35% of Indian output, has experienced adverse weather conditions. As a result, many mills have closed for the season. Last year they remained open until mid-June, but all mills are expected to be shuttered by the end of March. Early-season estimates for Maharashtra were as high as 13.8 million tonnes. Recent estimates put output at only 9.5 million tonnes.

In addition, the Indian government is taking its ethanol program seriously. In February the minimum ethanol blend was raised to 10% from 1.5%, two months ahead of schedule. And the plan is to move to E20 by 2025, five years before the original target date of 2030. In terms of actually implementing the plan, all cars have to be ethanol compliant by 2023 and E20 compliant by 2025. Maruti Suzuki, India's largest car manufacturer, announced that all new cars will be E20 compliant by April 2023.

In 2021-22 it is estimated that about 10% of the cane crop was diverted to ethanol. The spike in the minimum blend to E10 in the short term and doubling that to E20 over the next two years will definitely compromise India's ability to fill any gaps in world sugar trade.

Analysts have begun to trim their forecasts for a global 2022-23 sugar production/consumption surplus. We believe that those estimates are dated and do not include the bullish overtones of both a disappointing crush and ethanol advancements in India.

Back to Brazil, we do not believe that the ethanol/sugar crush-ratio forecasts are realistic. While high sugar prices provide an incentive to favor sugar production over ethanol, Brazilian ethanol demand has been growing steadily, and imports are still relied upon to meet domestic consumption. There is a limit therefore to how far the ratio can swing.

Maintain long positions in July 20 sugar calls as per our January 29 recommendation.

[By Sholom Sanik, March 10, 2023]

Chart 4 – ICE weekly sugar



Chart courtesy Reuters

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CORN

Supply problems? Yes. Shortage? No

In late February, corn prices broke down from a long-held trading range (Chart 5). It should not have come as any great surprise. Despite ongoing supply-side issues, the demand side has been a drag on this market.

Historically, Argentina has been the world's third-largest exporter, behind the US and Brazil. This season, however, inclement weather has decimated crops. The March USDA crop report slashed its estimate for the 2022-23 Argentinean output by 7 million tonnes, to 40 million tonnes, down from 49.8 million tonnes in 2021-22. In all likelihood, the USDA estimate is still vastly overstated. On March 16, the Buenos Aires Grains Exchange cut its estimate to 36 million tonnes. That will be the smallest crop in over 7 years.

The USDA maintained its 2022-23 Argentinean export estimate at 28 million tonnes, down from 34 million tonnes last year. However, that might be subject to revision as well.

Ukraine has traditionally been the fourth-largest exporter, but its situation is old news. Production is estimated at 27 million tonnes, down from 42.13 million tonnes in 2021-22.

While the pool of corn available for world trade has definitely shrunk, it appears that supplies are more than sufficient to meet demand. Over the past two weeks, US exports averaged about 1.3 million tonnes, the largest tally since January, but it did not generate much excitement. Too little, too late. The USDA estimate for 2022-23 exports is 46.99 million tonnes, down 25% from last year at this time. But even that is generous. US export commitments stand at a scant 31.9 million tonnes, down 39% from the same time last year.

US exports to China have all but reverted to the pre-2020-21 buying-binge levels. Total commitments stand at 4.56 million tonnes (shipped and unshipped), compared with 12.1 million tonnes and 19.4 million tonnes on this date in 2021-22 and 2020-21, respectively.

Looking ahead to the soon-to-be-planted US 2023-24 crop, March 31 planting intentions are just around the corner. The USDA's first forecast, published on February 23, shows a rather large increase. Farmers are expected to plant 91 million corn acres, up from 88.6 million acres for the 2022-23 crop. The initial yield estimate calls for a record 181.5 bushels per acre. Naturally, yield and harvested acreage are both subject to dramatic revisions based on weather. And in the case of planted acreage, price *vis-à-vis* soybeans will determine how much corn is actually planted.

The USDA estimate for 2022-23 ending stocks is 9.5% of consumption, just slightly higher than the past years. However, it is fair to say that this is a bit of a misnomer because, barring the appearance of a mystery buyer, we believe that the export estimate will have to be revised significantly lower.

We are short July corn as per our January 19 recommendation. Lower stops from $7.10 per bushel, to $6.40. close only. *[By Sholom Sanik, March 21, 2023]*

Chart 5 – CBOT July corn

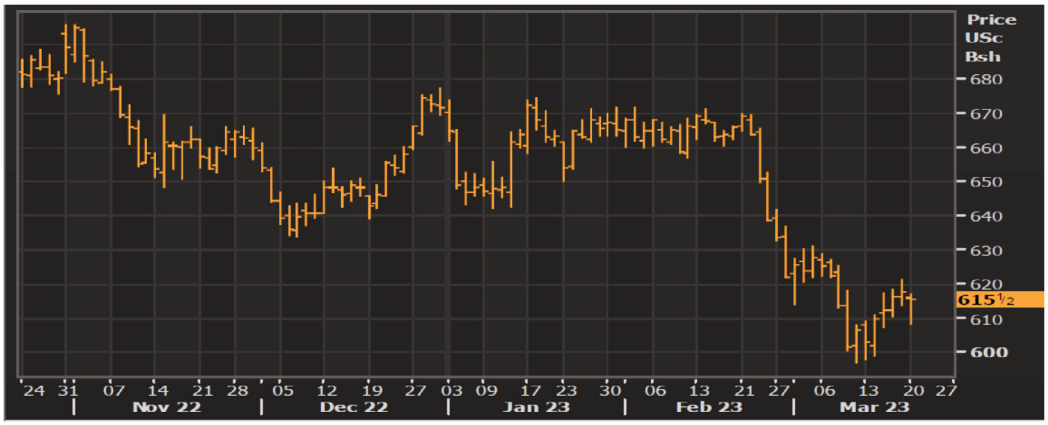


Chart courtesy Reuters

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SOYBEANS

The bull is back in the ring

Soybean prices were strong from the end of the 2022-23 US harvest through to the end of February. And for good reason. US exports were strong, and South American weather was challenging. Wet weather threatened a meaningful delay for the Brazilian harvest, and drought in Argentina was ushering in what could justifiably be called a crop failure. Then, in the space of just a couple of weeks in March, the entire rally was erased. Brazilian conditions had improved, exports slowed, and traders believed that US farmers were embarking on planting a huge crop for the 2023-24 crop year.

Apparently, the bearish exuberance was exaggerated. In the week leading up to the March 31 USDA US quarterly stocks and planting intentions report, the market rallied right back to just shy of the highs of the range (Chart 6).

Quarterly stocks, primarily a measure of domestic demand, were 1.685 billion bushels. The average guesstimate heading into the report was 1.742 billion bushels. After incorporating this into the 2022-23 US balance sheet, and with little change in other supply/demand items, US ending stocks would fall to 3.5% of consumption. That's the same level of carryover stocks we saw in 2019-20 and 2020-21, which eventually saw prices spike from $9 per bushel to $16. *Bona fide* tightness.

Owing to the fact that soybean prices were stronger against corn – its major acreage competitor – during the seeding-planning stages (Chart 7), soybean area was expected to jump. While planted acreage will be higher than last year's 87.2 million acres, survey participants weren't too sharp with acreage estimates either. The average trade guesstimate for soybean area was 88.24 million acres, but the actual figure came in at 87.5 million acres. Using a 50.73 bushel-per-acre yield (the average of the past three crops), that would represent about 37 million bushels fewer soybeans to be harvested than anticipated. Not an overwhelming amount, but together with the lower quarterly stocks figure, bullish sentiment was stoked. The session closed with May soybeans adding 30¢ per bushel to the robust week-old rally.

US export volumes have slowed down, which includes sales to China. Still, China has been an active buyer each week since mid-February when its string of large weekly sales ended. This is to be expected at this juncture in the season when South American origins will be favored.

The USDA forecast for 2022-23 final sales to all destinations is 54.84 million tonnes, or 6.6% lower than last season. Commitments stand at 49.76 million tonnes, 10% below last year at this time. Interestingly, the USDA actually revised its forecast upwards in the March crop report, perhaps because of the situation in South America.

Brazil is humming along fine, although its harvest is still lagging behind last year's pace. One recent estimate raised its output forecast for Brazilian output to 157.7 million tonnes, which compares with the USDA estimate at 153 million tonnes. Either way, it is a staggering increase over last year's final production of 129.50 million tonnes.

Argentinean output, however, will compromise most of those gains. Last year's production was 43.9 million tonnes, and this year's estimates keep dropping. The USDA is at 33 million tonnes, and one recent estimate claims that the harvest will reach only 22 to 23 million tonnes.

Commodity funds got spooked by what now seems to have been short-term factors. Chart 8 shows that funds liquidated close to 100,000 contracts, which was about half of their net-long position. Perhaps the export picture is somewhat less exciting, but then again, Argentinean availability may well have deteriorated.

Sadly, our $14.50 stop, basis the nearest contract month, was triggered on the nasty decline in mid-March. We do not believe that the operative fundamentals have changed very much from our original case in early February (see *Focus on Futures*, February 2).

We recommend re-establishing long positions in Jul soybeans, currently trading at about $14.80 per bushel. Place initial stops at $14.20, close only.

[By Sholom Sanik, April 5, 2023]

Chart 6 – CBOT July soybeans

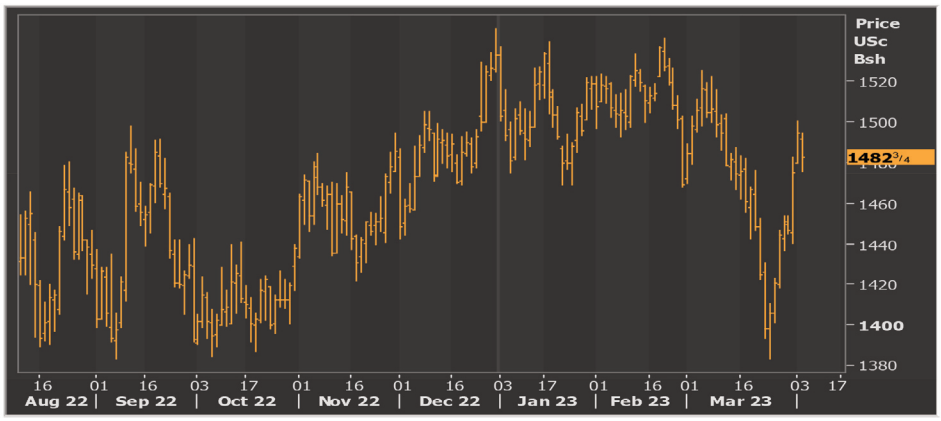


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Chart 7 – New crop soybeans/corn

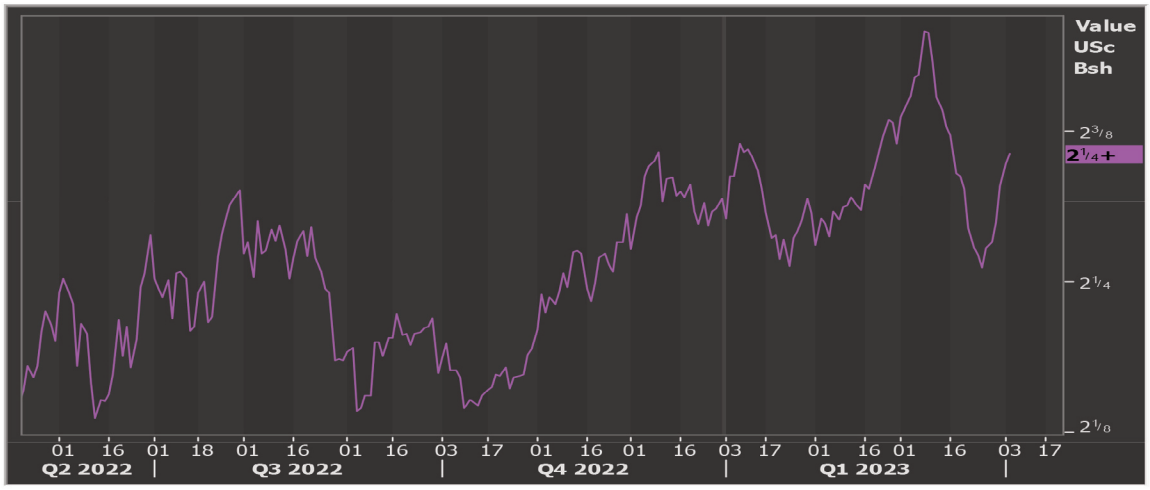


Chart courtesy Reuters

Chart 8 – CFTC managed funds soybeans net-long position

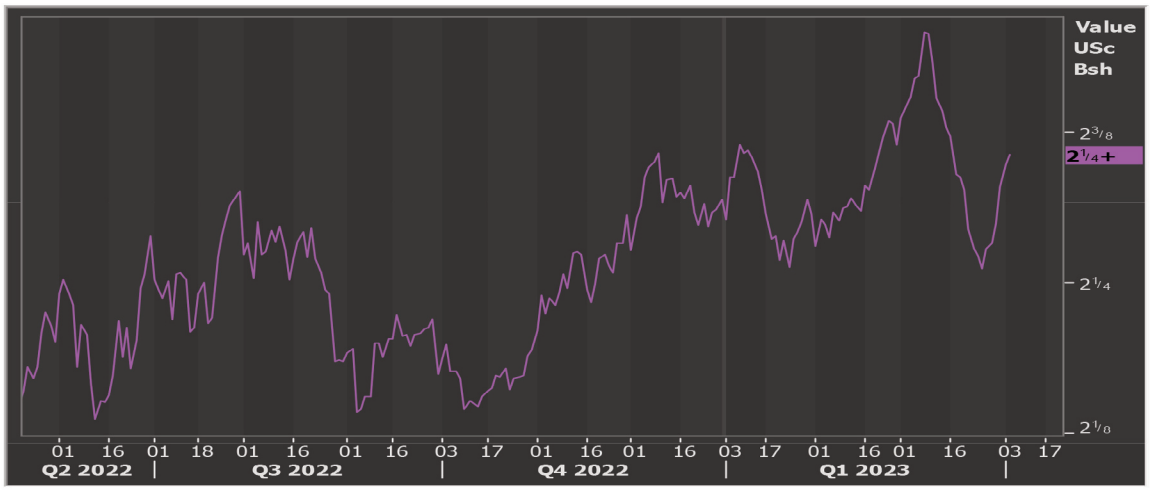


Chart courtesy Reuters

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