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Sugar: still all about energy

Sugar prices have been struggling in response to a series of supply-side bearish developments in the major producing/exporting countries.

India

The 2020-21 crushing season, which began late last year, is expected to yield record output of about 35 million tonnes. In addition, despite the government's removal of export incentives, exports are estimated by some analysts to climb to about 9 million tonnes, well above the 5 to 6 million tonnes sold abroad over the past few years.

Thailand

After two years of drought, Thai production is making a comeback. After achieving bountiful crops in the 2017-18 and 2018-19 marketing years, output sank to about 8 million tonnes. Recent estimates put 2021-22 production at 13 million tonnes.

The crushing seasons of these two Asian producers are now in full swing. The healthy crops will more than compensate for last year's frost-and-drought-affected Brazilian crops and certainly do qualify as bearish factors. We are seeing estimates for global surpluses of between 1 and 4 million tonnes.

Brazil

At issue, however, is the Brazilian crush going forward. Brazil just began its marketing year in April. Energy prices popped the way they did primarily because of the Russian/Ukrainian conflict. After a trip to $130 per barrel, crude oil prices plunged, but after settling into a range, the average price has hovered above a still very lofty price in historical terms of $100 per barrel.

The spillover into energy products and alternative fuels has kept ethanol at historically high prices as well. Chart 2 shows that after languishing earlier this year, Brazilian ethanol prices have gained more than 20% over the past six months to record highs.

With this increase in ethanol prices, it is more profitable to produce ethanol than sugar. And the data show it. Typically, the ethanol/sugar output ratio favors ethanol heavily in the first part of the crushing season because the cane is not fully mature and has lower sugar content. But this year, ethanol *vis-à-vis* sugar output has been off the charts. At one point, processors were diverting about 90% of cane to ethanol!

Now, of course, this ratio is not sustainable, but the analysts that are calling for a global sugar surplus are ignoring what is happening on the ground in Brazil. To illustrate, consider that some analysts are looking for Brazilian sugar production for 2022-23 to bounce back to 35 million tonnes in the Centre South region where 90% of cane grows, up from 29 million tonnes.

One prominent brokerage house dismisses this optimism, claiming that the others are not accounting for the ethanol factor and pegs Brazilian output at only 29 million tonnes. Sugar prices would have to be about 5% to 10% higher than current levels to provide the same profitability as ethanol at current levels. And there goes your global surplus!

We can expect the ratio to slip back materially once the

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cane crop is more mature. Most forecasts for the full season have been in the range of 55%/45% in favor of ethanol. We believe that at the very least, we will see the ratio back at 60%/40%. And with the hard evidence indicated by the current trend, we are likely see a record percentage of cane shifting to ethanol.

On December 10 we recommended an 18.25¢-per-pound stop on the nearby contract, which was subsequently triggered. We suggest re-entering the long side at this time. Buy October sugar, presently trading around 19.25¢. Place initial sell stops at 18.25¢, close only.

[By Sholom Sanik, May 13, 2022]

Chart 1 – ICE October sugar

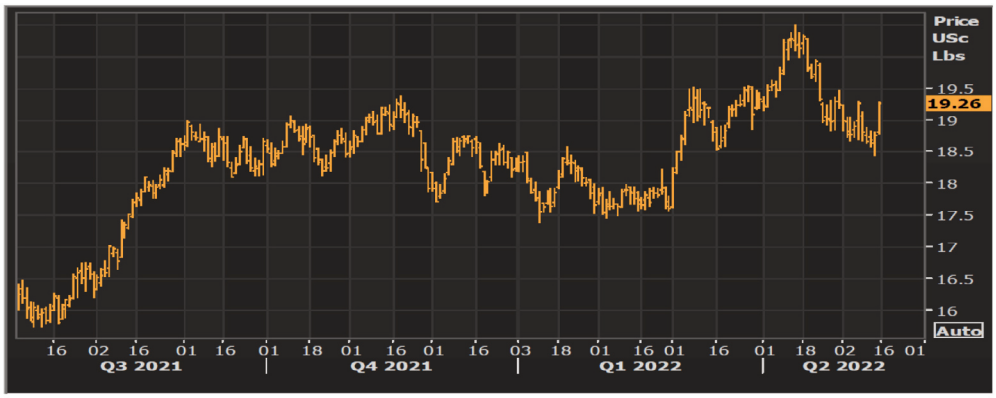


Chart courtesy Reuters

Chart 2 – Brazilian ethanol price (litre per Brazilian reals)

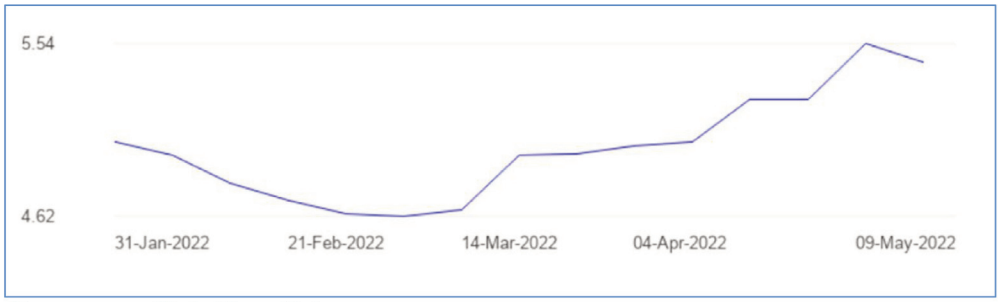


Chart source: GlobalPetrolPrices.com

SOYBEANS

No more bull

When viewing the US soybean balance sheet for the upcoming 2022-23 marketing year in isolation, the implication for soybean prices can be a bit confusing.

In the pre-Covid and pre-Chinese-tariff era, US farmers were already planting crops of about 90 million acres. Then demand for US soybeans fell materially as a result of these events. For the 2019-20 marketing year, planted area fell by 15% as farmers were saddled with burdensome stocks at the end of 2018-19, which reached an unprecedented 23% of usage. Domestic and export demand have since recovered steadily and are now back to the pre-crisis levels, mainly on account of a return of Chinese imports. Planted area grew steadily alongside the recovery in consumption: first to 83 million acres in 2020-21 and then to 87 million acres in 2021-22.

The lofty prices we experienced this year – new-crop November beans traded between $14 and $15 per bushel during the early part of the planting season, very close to historical highs – resulted almost entirely from the Russian-Ukrainian conflict and should have inspired farmers to plant a mega crop. And initially, it seemed that this was the case. The first USDA acreage estimate of the season on March 31 put soybean area at 91 million acres, a hefty 4.4% increase over the current 2021-22 marketing year. Were that estimate to have come to fruition, acreage would have been a record and even larger than the crops planted in the pre-Covid and pre-Chinese-tariff era.

Now, the street was aware that the March 31 estimate was somewhat unrealistic. Indeed, the average of pre-report

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guesstimates put planted area at 89.6 million acres. But the second estimate released on June 30 came in at only 88 million acres and provided quite the surprise. That should be bullish, right? The market rallied to greet the news, but closed out the session down on the day and has tumbled by as much as $2 per bushel since (Chart 3).

Furthermore, with the acreage estimate adjustment, the projection for US ending stocks fell to 230 million bushels, or 5.1% of usage, just a tad above the 4.8% figure that underpinned the start of the Russian-Ukrainian-conflict rally. So why did prices rise the way they did, and why are they falling if the crop size was a disappointment?

As we've stated previously, the only tangible connection to the conflict (Russian-Ukrainian) would be an increase in soybean production costs for exporting countries, which will result from higher energy costs and fertilizer costs (see *Focus on Futures*, April 7). That may very well still be the case. But neither Russia nor Ukraine grow any soybeans of consequence. Rather, we believe, the market has shifted its focus to the global supply situation, and at that, the US crop just does not matter the way it did in the past.

Brazilian and Argentinean crops have increased dramatically, particularly in Brazil. For the current 2021-22 marketing year, Brazilian output was compromised by weather, producing only 126 million tonnes, down from 139 million tonnes in 2020-21. However, if all goes well with this year's planting and growing seasons, Brazilian output is expected to reach 149 million tonnes. Combined, the two South American nations will produce 200 million tonnes of soybeans, compared with 120 million tonnes for the US (Chart 4).

While 2022-23 US production will not be as large as anticipated, Brazil and Argentina should ensure that there will be no tightness going forward. Global ending stocks are forecast at 99.61 million tonnes, or 26.4% of consumption, up from last year's 24.4%.

Our April 7 recommendation to sell soybeans short was stopped at $17.25, basis July. If you managed to hang on, continue to do so. For new positions, well, it's a long, hot summer and invariably we will get a rally. November soybeans are currently trading at $13.75. Be patient and attempt to establish a short position on a 40¢ to 50¢ rally. Place initial sell stops at $15.25, close only. *[By Sholom Sanik, July 26, 2022]*

Chart 3 – CBOT November soybeans

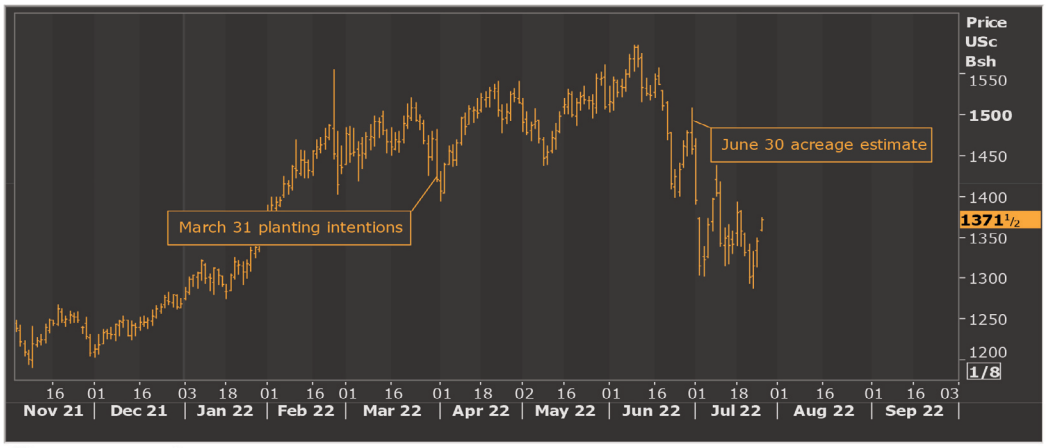


Chart courtesy Reuters

Chart 4 – US and South American soybean crops (million metric tonnes)

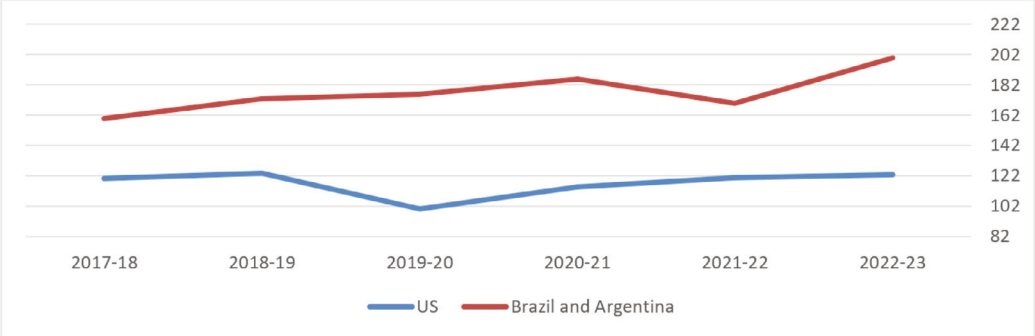


Chart source: USDA

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COCOA

Cocoa: why so weak?

Cocoa has been one of the worst-performing commodities this year (Chart 5).

Ivory Coast and Ghana grew record crops in 2020-21. Ivorian production was 2.191 million tonnes, 117,000 tonnes, or 5.6%, larger than in 2019-20, and Ghanian output was an off-the-charts 1.04 million tonnes, 270,000 tonnes, or 35%, bigger than the previous season.

Neither country repeated these feats in the soon-to-be-concluded 2021-22 crop year. With about two months remaining in the mid-crop season, Ivory Coast arrivals stand at 2.013 million tonnes, 85,000 tonnes below this time last year. There is not much available data for Ghana, but in mid-June, arrivals had reached 650,000 tonnes. The International Cocoa Organization (ICCO) estimates that 2021-22 output will be 800,000 tonnes, and it would seem that this target is achievable. Weather conditions were on and off throughout the season for the West African growing nations. In addition, persistent disease issues and aging plantations were the culprits for the smaller crops.

On the demand side, grinding in the traditional processing nations was mixed. Recently released results for the second quarter show that the EU was up 2% year-over-year, with Asia at plus 3.6%. North America, however, was down 6.29%. Ivory Coast grindings were 10.7% higher.

It seemed that the new supply created in 2020-21 would overwhelm the market for that season and next. Indeed, it is precisely the reason cocoa prices have performed so poorly. However, the slump in production, combined with reasonable growth in grindings, has drawn global stock levels down to their lowest level in seven years (Chart 6). The ICCO is forecasting a 2021-22 production/consumption deficit of 176,000 tonnes.

So it sounds like a bullish case in the making. We attempt to focus almost exclusively on supply and demand issues in these pages, and from that standpoint, it certainly seems that cocoa would qualify as a "cheap" commodity that should be traded from the long side.

The problem we have is that it is hard to ignore an absolutely definitive downtrend that has generated no interest from commodity funds – which are net-short this market – even during periods in the past six months when many commodities that had no *bona fide* bullish fundamentals were flying high.

There are two potential factors to explain the weakness. First, without the benefit of timely information coming out of Ghana, it is very possible that output is not quite as weak as we are led to believe. It is hard to understand how production went from boom to bust in the space of just one year. The 1.04-million-tonne crop is a hard fact. The estimates for this year, at this point, are merely estimates.

In addition, the early outlook for next year's crops in Ivory Coast and Ghana – for some regions, the harvest is less than two months away – is favorable. Without extraordinary weather setbacks, we should assume that we will return to trendline growth.

Stand aside, but stay tuned.

[By Sholom Sanik, July 29, 2022]

Chart 5 – ICE September cocoa

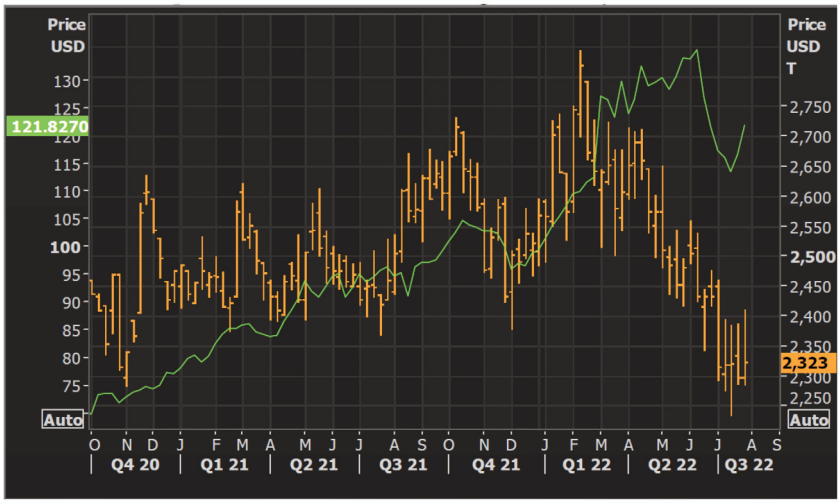


Chart courtesy Reuters

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Chart 6 – Global cocoa – stocks-to-grindings ratio

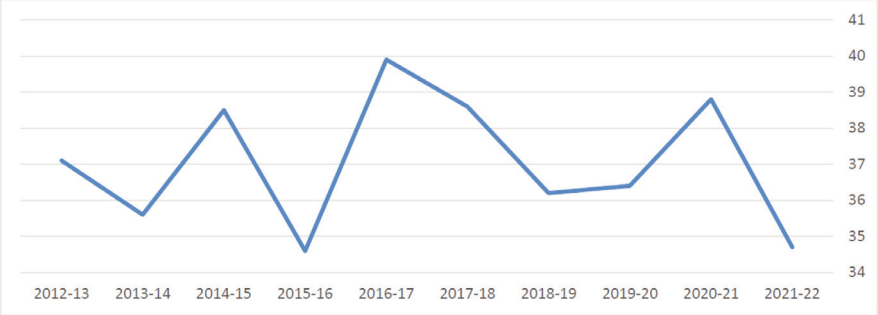


Chart source: International Cocoa Organization

COTTON

Have we run out?

As the Ukrainian/Russian crisis slowly began to fade from the headlines and talk of grain shipments from the region emerged, US crop prices came tumbling back to earth. Not that all markets that had risen had much connection – if any – to the crisis. Cotton and soybeans (Charts 7 and 8) came along for the ride, ostensibly because of higher production costs related to energy, and then fell alongside corn and wheat when the urgency softened. Then hot and dry growing conditions in the US saw prices recover some of the sharp early-summer losses.

More often than not, the USDA is cautious with regard to altering its production estimates until the crops are made. Although conditions deteriorated for all crops, for the most part, the revisions in the August 12 crop report for the soon-to-be harvested 2022-23 crops were modest. In fact, the estimate for soybean yields was actually increased from the July estimate.

Not so for cotton. The USDA was very definitive. The July estimate for the US crop was 15.5 million bales. The average of analysts' guesstimates was 14 million bales, but the USDA came in at 12.5 million bales. This will be dramatically lower than the 17.5 million bales harvested in 2021-22.

The area that survived the drought fared well with a yield of 846 pounds per acre, which is actually higher than last year's 819 pounds per acre. However, the estimate of harvested to planted acres nosedived to 57%, down from the July estimate of 68%. That compares with 92% in 2021-22 and 68% the season before that. The ratio of harvested to planted acres was not this low even during the bull market of 2011, when prices skyrocketed to $2.25 per pound.

Consider the implications: The US has been exporting roughly 15 million bales over the past several seasons and consuming 2.5 million bales domestically. With a carryover of 3.5 million bales from 2021-22, total US supplies will be 16 million bales. Export commitments stand at 7.3 million bales, about 40% ahead of this time last year.

US farmers cannot sell what they don't have and as a result, the USDA cut the export forecast down to 12 million bales. Assuming domestic usage remains constant at about 2.5 million bales, ending stocks would fall to 180 million bales, or 12% of consumption, possibly the lowest on record.

Can any of the other major producing nations pick up the slack?

India

India is expected to produce 27 million bales, up from 25 million last year. Domestic consumption is 25 million bales, and they typically export about 3.5 million bales. So, there is perhaps something to work with there.

China

Chinese output will be slightly larger than last year's at 27.50 million bales, but domestic consumption is estimated at 37.5 million bales. With 10 million bales required to fill the gap, China is part of the problem.

Australia

At 5.5 million bales, output will be about the same as this past season. Domestic usage is negligible, leaving just about the entire crop for export. The problem here is that the crop is not harvested until next March.

Brazil

As with other commodities, Brazilian farmers are expanding. Over the past several seasons, production has grown by about 1 million tonnes per annum. The coming crop is expected to yield about 13 million bales. Only about 3.5 million tonnes

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are used domestically, and there is a sizeable carryout of 12.8 million bales – according to official figures. So, this is the one sweet spot that could alleviate the tightness created by the dismal US crop. Again, like Australia, we will not see any new cotton until next spring.

We are headed into the third consecutive season of global production/consumption deficits – with a larger deficit for 2022-23 than we knew about until the weather in the US deteriorated. Global ending stocks are still showing a 69.5% of consumption carryout, but as we have discussed many times over the years, almost half of that is *reported* Chinese stocks, which either do not exist or are unusable. Otherwise, they would not be importing.

In the meantime, the countries that may be able to fill the vacuum left by the small US crop will not be able to do so for at least six months. Tightness is on the horizon.

At present, the market is consolidating the 15¢-per-pound rally triggered by the USDA crop report. Establish long positions in December cotton. Place initial sell stops at 99¢, close only. *[By Sholom Sanik, August 19, 2022]*

Chart 7 – ICE December cotton



Chart courtesy Reuters

Chart 8 – CBOT November soybeans



Chart courtesy Reuters

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