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Cotton: large crops, demand beneath the surface

Cotton is trading at 18-month lows.

The most significant event to affect the cotton market recently was the June 28 USDA acreage report. Traders were taken by complete surprise with a higher-than-expected acreage update. While polled analysts were way off the mark with their acreage guesstimates (see *Focus on Futures*, June 28), the increase in planted area was obviously well known. The optimum cotton-planting window in the US closes around mid-May, and the market had already begun heading south right at that time (Chart 1).

The mid-July crop report kept the yield estimate steady at 844 pounds per acre, but lowered the harvested-to-planted ratio to 82.9% from 85.5%. Still, with an additional 1 million acres to work with, the production estimate jumped by 1 million bales, or 6.25%.

In terms of crop conditions, the most recent USDA weekly progress report shows that 53% of the crop is in the good-to-excellent category. That is a big jump from the previous week's 45% rating and compares with 46% last year at this time. The five-year average is 50% for this time of year. So, the crop is larger than we believed several months ago and is certainly off to a good start.

Texas is the largest cotton state, and for the most part rain has been favorable, as evidenced by the improved crop conditions. But we are far from locking in an optimum crop. The High Plains region in West Texas, where about 65% of the state's cotton is grown, is expecting dry weather until the end of July.

The USDA left Brazilian cotton production unchanged for both 2023-24 and 2024-25, at 14.57 and 16.7 million bales, respectively. Brazil is just about tied with the US for billing as the world's largest producing and exporting nation. In 2022-23 Brazilian exports were 6.66 million bales. The estimate for 2023-24 is 12.30 million bales. In the space of just one season, exports have almost doubled.

Meanwhile, the USDA estimate for US 2023-24 exports has been inching down and now stands at 11.6 million bales. And at that, that target is not going to be met. With two weekly reporting weeks left to the 2023-24 marketing year, US export shipments have reached only 10.07 million bales. Export commitments stand at 13.02 million bales, so the balance of unshipped cotton orders will be tacked on to the 2024-25 marketing year.

It is not as though end-user demand for cotton products is weak. Rather, Brazil's competition with the US has reached a new paradigm, which should manifest in keeping US prices soft *vis-à-vis* Brazil. In fact, the USDA is forecasting improved global demand for the upcoming 2024-25 marketing year, with an estimate of 117.2 million bales, or 3.5% higher than this past season. Production, however, is estimated to grow by 5.7%.

To illustrate this point, one interesting demand-side indicator, which we have not presented in some time, is US retail clothing sales. It is a worthy indicator of cotton demand because about 60% of all clothing worn in the US is made of cotton. The St. Louis Fed publishes the monthly *Advance Retail Sales: Clothing and Clothing Accessory Stores* survey. The most recent figure shows that sales have completed a recovery from Covid and have reached new highs (Chart 2).

All eyes are focused on large crops in the US and Brazil. As is customary, commodity funds are following the trend and have built a gargantuan short position (Chart 3). Over the past five months they have shifted from a 90,000-contract long position to a 40,000-contract short position. Although we have presented a rather bearish case for US cotton prices, healthy crops are "in the market," and a stint of dry weather will spark short covering. We therefore recommend observing from the sidelines, but stay tuned.

[By Sholom Sanik, July 24, 2024]

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Chart 1 – ICE December cotton



Chart courtesy Reuters

Chart 2 – St. Louis Fed's Advance Retail Sales: Clothing and Clothing Accessory Stores

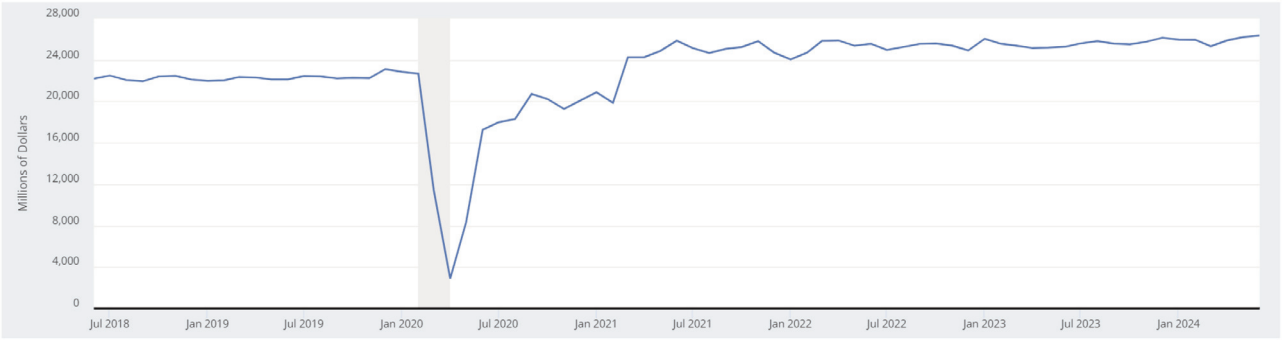


Chart courtesy Federal Reserve Bank St. Louis

Chart 3 – CFTC Commodity funds cotton net-short position

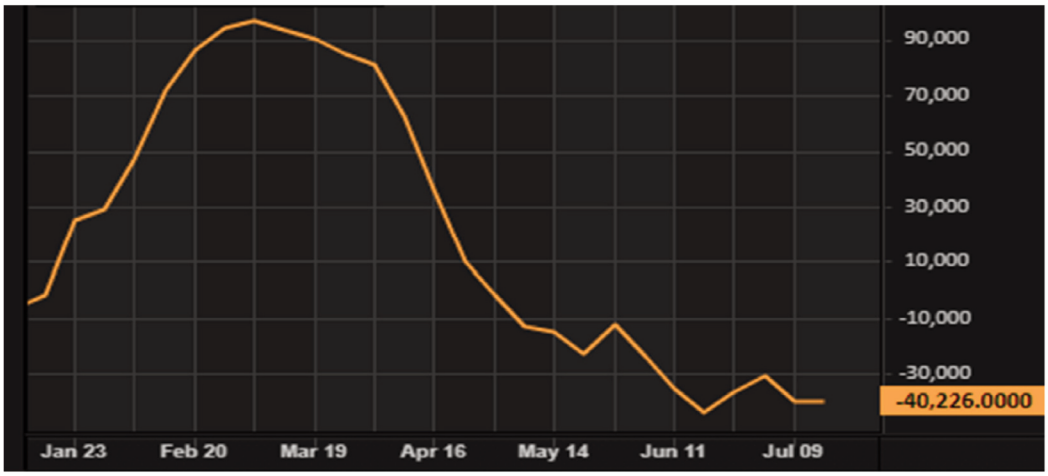


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SUGAR

Is Brazil faltering?

Brazil

In recent articles regarding sugar, we have been harping on the reality that estimates for Brazilian output might be too generous. Weather in the growing season was not sufficiently wet to ensure healthy subsoil moisture. More significantly, the cane area for the crop that is being crushed is about 10% below the previous year.

For the most part, the biweekly production reports out of Brazil showed higher output than the comparable periods a year earlier. The rationale for a strong 2023-24 season was the expectation that crushers would push the sugar/ethanol ratio as far as they can. And, indeed, that has been the case. For most of the crush season that began in April, the ratio has been over 49% in favor of sugar, higher than last season.

The market responded in kind. Over the past several weeks, October sugar has been in steady decline. The spring lows were violated and, certainly for technical analysts, it appeared that the curtain was being drawn on this bull market. However, the most recent slate of statistics has been indicating that while crushers have been maximizing sugar output, the overall outlook for production is not quite as large as previously believed.

First, despite the stream of robust bi-weekly updates, on July 24 one prominent softs analyst revised its output forecast for the Centre-South region, where 90% of Brazilian sugar is grown, to 40.5 million tonnes, down from an earlier estimate of 42.3 million tonnes.

Then, the following day, the biweekly report showed that sugar production was down an unexpected 9.7% for the first half of July, compared with the same period in the previous season. The sugar/ethanol ratio maintained its poise at 49.88% for the period, but obviously on lower cane volume. That spooked the bear community enough to erase some recent losses (Chart 4).

India

For the near term, not much has changed. The 2023-24 crush has ended. The estimates for output have been about the same over the past couple of months. With production of about 31 million tonnes pitted against domestic consumption, which has now surpassed 29 million tonnes, not much has been accomplished in terms of padding inventories. There has been no indication that the government has any intention of repealing the zero-exports policy.

Looking ahead, the June-to-September monsoon is the key to next year's crop. After a slow start, heavy rains have pounded India, including the two largest producing states, Uttar Pradesh and Maharashtra. At the moment, we are not aware of any information regarding crop damage from flooding, but ultimately, subsoil moisture replenishment is a good thing. Either way, we do not believe there would be any implications for the near-term, because the affected crops are not harvested until November.

As we previously noted (see *Focus on Futures*, June 21) the International Sugar Organization actually revised its estimate for the global production/consumption balance for the current marketing year, from a near-balanced market to a 3-million-tonne deficit. Hard to say whether that included a downturn in Brazilian output. If it did not, then, without India's presence in global trade, we are looking at a scenario where supplies could tighten going forward.

We are long October sugar as per our April 19 recommendation. We came within a whisker of triggering our 17.5¢ per pound stop, but survived. Remain long.

[By Sholom Sanik, July 26, 2024]

Chart 4 – ICE October sugar

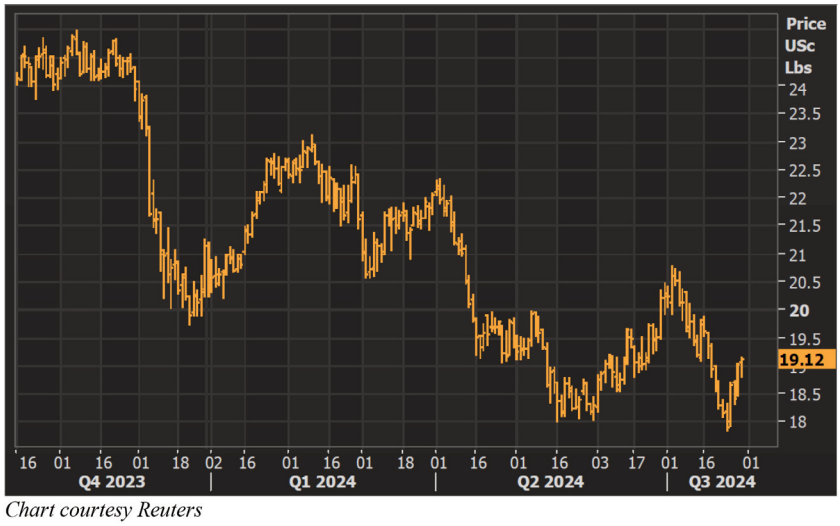


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SOYBEANS

A bear all around

With bountiful crops expected in the US this fall and next spring in Brazil, the 2024-25 global balance sheet shows a market bursting at the seams with soybeans. According to the USDA July crop report, ending stocks are estimated at 128 million tonnes, or 31.8% of consumption. That compares with 27.4% and 29.1% in 2022-23 and 2023-24, respectively. In terms of recent history, that level of inventories rivals only the 2018-19 marketing year when ending stocks were 33.3% of usage.

As far as Brazil is concerned, the USDA is forecasting a record 169-million-tonne crop. One local analyst puts output at 171.5 million tonnes. That compares with 162 and 153 million tonnes, in 2022-23 and 2023-24, respectively. The new-crop estimates are based on planting intentions. Planting does not commence until September, so these estimates will not vary materially until we get a look at planting and growing weather down the road.

The 2023-24 crop that is currently being harvested disappointed on account of weather. The USDA's 153-million-tonne estimate may even be a tad optimistic. Local analysts have lower estimates, with one forecast at 147.5 million tonnes. But this has been well known for some time.

In the near term, all eyes are on the US crop. According to the June 28 acreage update, farmers planted 86.1 million acres of soybeans, up 2.5 million acres from the previous season. And thus far, the crop is in good shape. As of the most recent weekly crop-progress report, 67% of the crop was in the good-to-excellent category. That stands in sharp contrast to last year at this time when that figure was only 52%.

The demand side has exacerbated the bearish outlook. The USDA has a rosy outlook for the coming marketing year, with a forecast for global demand to jump by 5% from 2023-24, to 401 million tonnes. However, current business conditions have been sluggish.

US export commitments stand at 45.3 million tonnes. The USDA forecast for 2023-24 export sales is 46.27 million tonnes. We are not going to reach the target nor will all the commitments be shipped. As of the most recent weekly export report, only 42 million tonnes have been shipped, and there are five weekly reporting periods left. We would need to improve on the recent pace of about 300,000 tonnes shipped per week to make the USDA estimate.

The USDA forecast for 2024-25 export sales is 49.67 million tonnes, and that estimate is not off to a good start either. New-crop sales stand at 2.9 million tonnes, compared with 5.5 million tonnes at this time last year.

In conclusion, although we have presented a bearish view, we cannot in good conscience recommend establishing a short position after soybeans have fallen by $2 per bushel to a four-year low since the planting season began (Chart 5). There are three variables to consider.

First, the US crop is not "made." Harvesting does not begin until October, and weather is still a factor.

Second, as we have seen from this season, early Brazilian estimates are no guarantee. To achieve a 169-million-tonne crop, good weather will be essential for the planting and growing seasons.

Finally, the USDA estimates Chinese demand at 126.8 million tonnes, close to 4% above 2023-24. Chinese production has not expanded and still represents only 15% of consumption. As illustrated, demand-side indications remain sluggish, but that could change.

Stand aside, but stay tuned.

[By Sholom Sanik, July 31, 2024]

Chart 5 – CBOT weekly nearest contract soybeans



Chart courtesy Reuters

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COCOA

Will this bull ever get tired?

After a steep plunge in June, cocoa prices consolidated during July. There have not been any stark new developments. With only a few weeks remaining in the mid-crop season, Ivory Coast production is pretty much in the books. Based on the pace of arrivals, which has not varied much in recent months, output will reach only about 1.75 million tonnes, or 27% below 2022-23. Ghanaian output will be about 40% below the previous season, at roughly 450,000 tonnes.

The operative focus going forward will be on the new crop. Actually, over the past three weekly reporting periods, Ivory Coast mid-crop results showed some sign of life. Cumulative arrivals were 38,000 tonnes, compared with 33,000 tonnes for the same period last year. That would be the first time that we saw higher year-over-year arrivals since near the beginning of the marketing year back in October. To be sure, we are talking an insignificant amount when stacked up against the calamitous 2023-24 maincrop. However, it might perhaps be an indication that the worst of the disease scourge has passed.

For what it's worth, recent estimates for the new crop are showing some optimism. In a Reuters survey, analysts estimate that Ivory Coast production will snap back to 2 million tonnes, while Ghana will produce 640,000 tonnes. Bearing in mind that trees affected by Swollen Shoot disease have to be uprooted and new trees don't bear fruit for years, we have to be at least somewhat skeptical that these numbers are achievable.

In the meantime, the steep backwardation (Chart 7) in the market is testimony of the supply tightness generated by the crop failures in Ivory Coast and Ghana. It will take quite a recovery to restore a global production/consumption balance in the market. The most recent International Cocoa Organization (ICCO) increased its 2023-24 deficit forecast, from 379,000 tonnes to 425,000 tonnes. The Reuters survey mentioned earlier has an average guesstimate for a record 475,000-tonne deficit.

However, looking forward, the survey's forecast calls for a 108,500-tonne surplus for 2024-25. You may justifiably wonder how that is possible. The traditional metric for assessing cocoa consumption has been grinding data. Thus far, aside from a sharp drop in origin countries where there were simply fewer beans to grind, processing in the EU and North America has been fairly steady. Results for the second quarter showed both EU and North America with year-over-year gains of 2.23% and 4.1%, respectively.

The major chocolate manufacturers have been tight lipped about how they are dealing with the sharp drop in supplies. One industry CEO cited *de facto* end-product price increases with a strategy of lowering chocolate content in products rather than raising per unit pricing. This could explain, at least partially, how a modest recovery in production will couple with a modest drop in disappearance to balance the global market.

We are two months away from getting a first glimpse of 2024-25 main-crop port arrivals. Weather is reportedly friendly in West Africa.

In terms of trading strategy, this market has become a monster of volatility. We are therefore hesitant to make any recommendations at this time. Any hint of a return to normal output levels in West Africa will spell the end of this bull market. At the moment, remain sidelined, but stay tuned.

[By Sholom Sanik, August 9, 2024]

Chart 6 – ICE September cocoa



Chart courtesy Reuters

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Chart 7 – September 2024/March 2025 cocoa spread



Chart courtesy Reuters

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