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Sugar: Why so sweet?

Sugar prices have rallied over the past month, sprinting to five-month highs even while many other commodities have been on the defensive (Chart 1). This rally was somewhat counter intuitive.

Brazil

The 2022-23 crushing season is winding down, and estimates for the Centre-South region, where 90% of Brazil's sugarcane is grown, haven fallen slightly over the past several months, from 35 million tonnes to 32 million tonnes. However, those estimates may be dated because over the past two months we have seen the ethanol/sugar ratio fall to about 53%/47%. Earlier in the season that ratio was averaging 59%/41%.

Furthermore, forecasts for 2023-24 output are in the 35-36-million-tonne range. This is based on estimates for a sugarcane crop of 575 million tonnes versus 540 million tonnes in 2022-23. Crushing does not begin until April, so the two variables, weather and ethanol prices, could see this forecast fluctuate materially.

Either way, it appears that we've muddled through the dire predictions for at least one year of challenged crops that resulted from the devastating frosts in the summer of 2021.

Ethanol prices have flatlined over the past several months, but overall, they have behaved much like crude oil prices, having fallen by about 20% from the mid-year peak. Sugar prices, on the other hand, may have been rangebound during this period, but have maintained the bulk of their bull market gains.

India

Over the past year, India stepped in to compensate for the sharp drop in Brazilian and Thai supplies. Indian exports rose to about 10 million tonnes, up from 5 to 6 million tonnes that were sold abroad over the past several years. For both the 2021-22 and 2022-23 Brazilian marketing years, exports fell to about 25 million tonnes, down from 32 million tonnes in 2020-21. Although Brazilian output is expected to recover, as noted above, new-crop supplies are not available in earnest until mid-2023.

In late October, however, the Indian government announced that it is capping exports at 6 million tonnes for the 2022-23 marketing year. Chart 1 shows fairly clearly that the street deemed this event to be extremely bullish as the recent low coincided with the news. As long as India was expected to fill the gap left by Brazil, the market ignored the improvement in Brazilian production.

Thailand

Thai production has recovered from two consecutive drought-ravaged seasons in 2019-20 and 2020-21. Output fell to 8 million tonnes from 14.5 million tonnes. Production for 2021-22 was about 10 million tonnes and is expected to reach about the same in 2022-23, still far shy of the pre-drought years. Exports for 2021-22 popped back to 10 million tonnes, and the forecast for 2022-23 exports is also 10 million tonnes. This is up from 6.7 million tonnes in 2019-20 and 3.7 million tonnes in 2020-21. But herein, perhaps, lies part of the problem. If Thailand

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actually sells that much sugar, it would mean that inventories are being sold off. Ending stocks would fall to below 4 million tonnes, where they were normally about 8 million tonnes.

Most analysts are forecasting a global production/consumption surplus for 2022-23 of several million tonnes. Aside from the Indian export restrictions, there is nothing screamingly bullish about this market.

We are long May 1850 calls as per our August 26 recommendation. We do not advise adding to long positions at this juncture. By the same token, with the comfort of a low-risk option strategy, why fight the tape? We do, however, suggest liquidating long calls on a close below 19.5¢, basis March.

[By Sholom Sanik, November 21, 2022]

Chart 1 – March ICE sugar

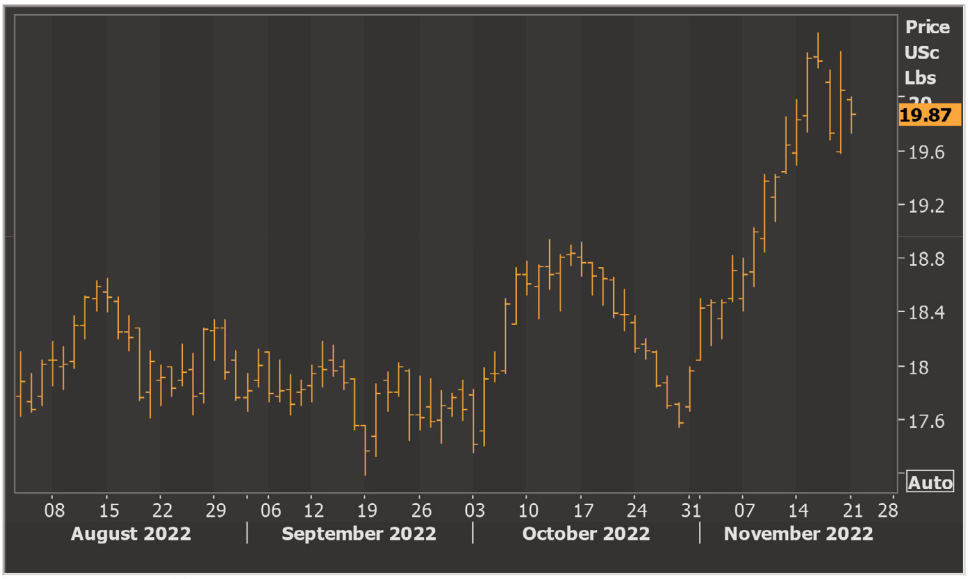


Chart courtesy Reuters

COTTON

Lower supplies, but soft demand

Cotton prices have bounced off a two-year low with an impressive 13¢-per-pound rally that began in early November. Even so, we are 50% off the $1.58-per-pound high set back in May (Chart 2). It would be a challenge to explain the sheer magnitude of the run to 10-year highs in terms of supply/demand fundamentals specific to cotton. Equally so, however, the selloff down to the average price range of the past 10 years may very well designate cotton as an undervalued commodity.

The most bearish argument for cotton has been concern over lost demand that could result from a slowdown in China, related to Covid lockdowns. While there is some evidence that this is accurate, the USDA balance sheets for the 2022-23 marketing year have already been discounting slower demand over the past several months. On the US side, total exports are estimated at 12.50 million bales. Global usage is estimated at 114.95 million bales, down from 123.13 and 117.37 million bales, in 2020-21 and 2021-22, respectively. The bullish arguments, however, persist.

While production costs may have been moderated by the broad drop in commodity prices, energy prices are still well above the historical norm. This includes the cost of running machinery, and perhaps most notable, the cost of nitrogen fertilizer, which is made from natural gas (Chart 3).

Production forms the primary bullish case. When the 2022-23 US crop was planted, cotton prices were at the high end of their historical range *vis-à-vis* alternative crops, such as soybeans (Chart 4). As a result, farmers planted considerably more cotton than in recent years – 13.79 million acres versus 11.22 million acres in 2021-22.

But weather was not kind to cotton. The harvested-to-planted ratio was basically a bust – 57% compared

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with 92% in 2021-22. The USDA November output estimate was 14.03 million bales, down from 17.52 million bales the previous season. The prospect for any upward revision for the crop is slim. The last USDA progress at the end of October showed the good-to-excellent portion of the crop at 31%, compared with 64% at the same time last year!

Looking ahead to the 2023-24 season, for which planting plans will be made soon, the odds are that farmers will not favor cotton over alternative crops. Chart 5 shows that new-crop soybean prices remain much closer to the high of the historical range than cotton prices.

Further on the output side, we believe the market has ignored the potential fallout from the Pakistani floods back in September (see *Focus on Futures*, September 28). A report earlier this month indicated that about 40% of cotton area was affected. Some crops were lost completely while others will suffer yield loss. In the November crop report, the USDA lowered its estimate for Pakistani output to 4.5 million bales from 5.2 million bales. That may still be an optimistic outlook.

There is no doubt that the demand side is soft. US exports were running ahead of last year's pace as recently as early November. We have now slipped back. As of the most recent weekly USDA export report, commitments stand at 8.7 million bales, down from 9.3 million bales at this time last year.

We were stopped out of our long March cotton position at 78¢ per pound. The supply side problems are not going to go away. Naturally, if demand remains weak, we will muddle through with lower output. At this point we recommend standing aside. However, we suggest watching weekly US exports carefully. If there is a return to normal purchasing patterns, we will be a buyer. Stay tuned.

[By Sholom Sanik, December 1, 2022]

Chart 2 – Weekly ICE cotton

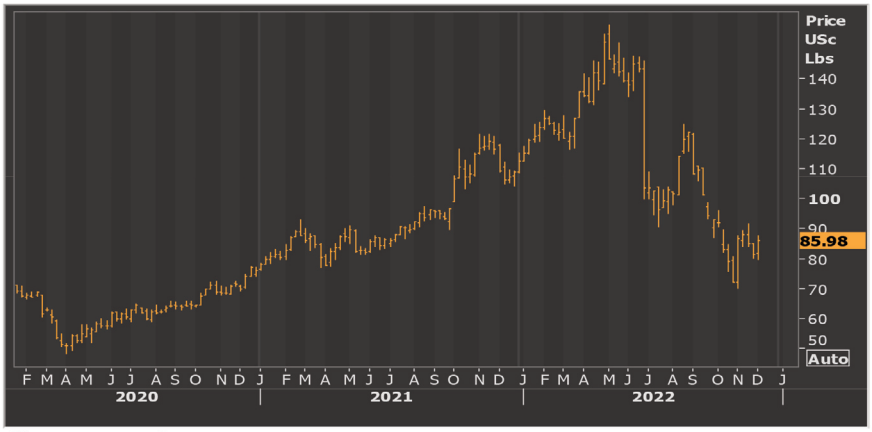


Chart courtesy Reuters

Chart 3 – Index of US fertilizer prices

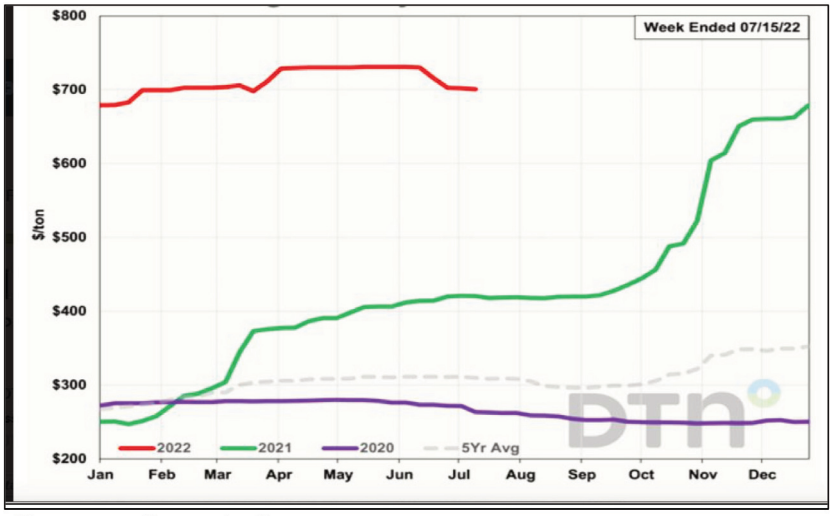


Chart source: Progressive Farmer

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Chart 4 – Historical ratio of soybeans vs cotton

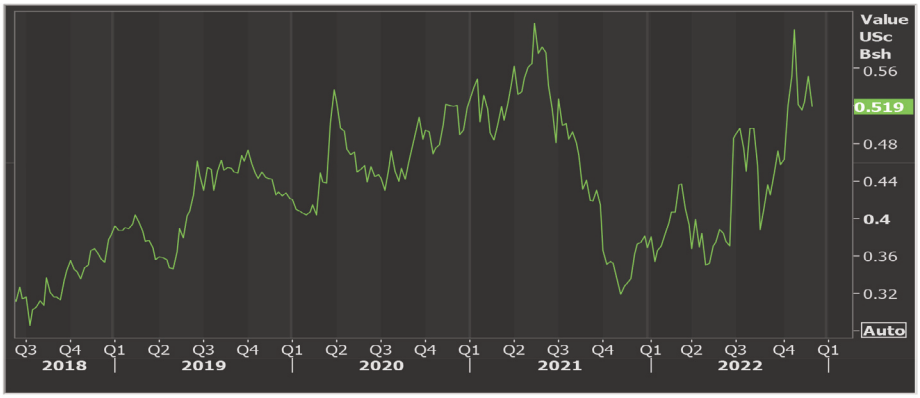


Chart courtesy Reuters

Chart 5 – New crop soybean/cotton ratio

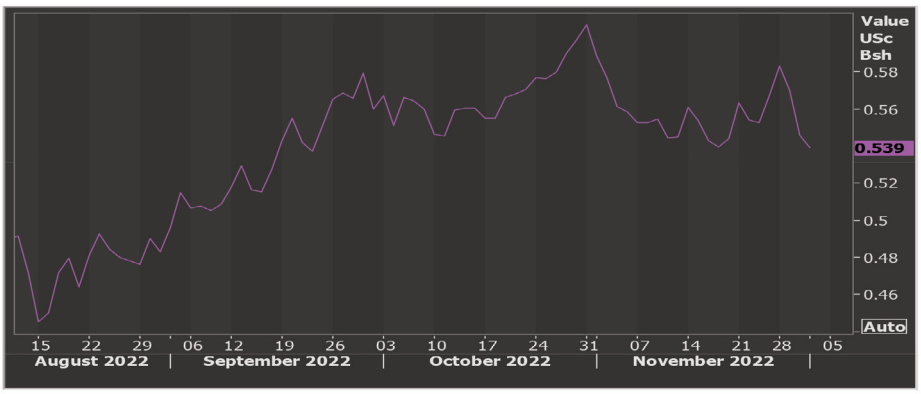


Chart courtesy Reuters

COCOA

If Ghana comes through

The 2021-22 Ivory Coast mid-crop was completed at the end of September. Combined main- and mid-crop arrivals totaled 2.106 million tonnes, 88,000 tonnes below the previous year's record crop. After the first two months of the 2022-23 main-crop harvest in the Ivory Coast, it seemed that we would follow with another off year for production. As recently as November 21, weekly port arrivals stood at 595,000 tonnes, 24,000 tonnes *below* the same time last year. As the harvest progressed, however, the pace has improved. The December 11 update showed arrivals at 954,000 tonnes, 87,000 tonnes *ahead* of last year. Incidentally, on this date in the record-output season of 2020-21, arrivals stood at 920,000 tonnes. Of course, there is still ample time for inclement weather. But at the moment, we are certainly on track for a decent year of output.

The World's second largest producer, Ghana, had a dismal crop in 2021-22. Final output reached about 690,000 tonnes, below early-season forecasts of 800,000 tonnes, and down dramatically from the record of over 1 million tonnes achieved in 2020-21. It was the smallest crop in 12 years.

Information for Ghanaian cocoa output is scarce, with virtually no statistics available on the outlook for 2022-23. Indeed, the International Cocoa Organization (ICCO) stated in its most recent monthly summary: "… no fresh data were available on the level of volumes of graded and sealed cocoa beans for the 2022/23 season ….".

Last year's smaller output was the result of plant disease and a reduction in the use of fertilizer because of higher costs, and both problems could still be an issue. Still, cocoa bean exports typically comprise about 25% of total Ghanaian exports, so there is certainly motivation to get back on track with a trendline crop.

Demand, as measured by cocoa grindings, has been firm. Third quarter results for the EU showed a year-over-year

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decline of 1.6%, while North America was down 3.4%. However, processing in the origin regions continues to grow. The Asian grind rose by 9.5%. West African grinding, which is mostly the Ivory Coast, now comprises close to half of the global grind and rose by 18.1% for the period.

The global production/consumption balance sheet shows a wide deficit. The ICCO has consistently increased its deficit forecast throughout the 2021-22 marketing year. On December 1 it estimated a shortfall of 306,000 tonnes, up from the previous estimate of 230,000 tonnes. Earlier in the season that estimate was 174,000 tonnes. The primary reason for the revisions was the poor showing for Ghanian output.

Looking forward, a survey of cocoa analysts conducted several months ago indicated that global production/consumption for the 2022-23 marketing year would be balanced. At the time, moving from a large deficit to a balanced market may have appeared to be a bit of a stretch because moderate output was assumed for the Ivory Coast. Now, with arrivals well out ahead of expectations, production is estimated at 2.3 million tonnes. That is about 200,000 tonnes more than last year. And if Ghana returns to normal output, we could well creep into surplus territory.

All told, grindings are growing at 3% to 4% per annum, and there is unlikely to be much volatility on that front. But if the above output forecasts are anywhere near accurate, global production would jump by 6% to 7%.

We're going to continue to recommend to be sidelined (see *Focus on Futures*, July 29). However, if it emerges that Ghanaian output returns to the 800,000- to 850,000-tonne range, we will look to trade this market from the short side. Stay tuned.

[By Sholom Sanik, December 15, 2022]

Chart 6 – ICE March cocoa

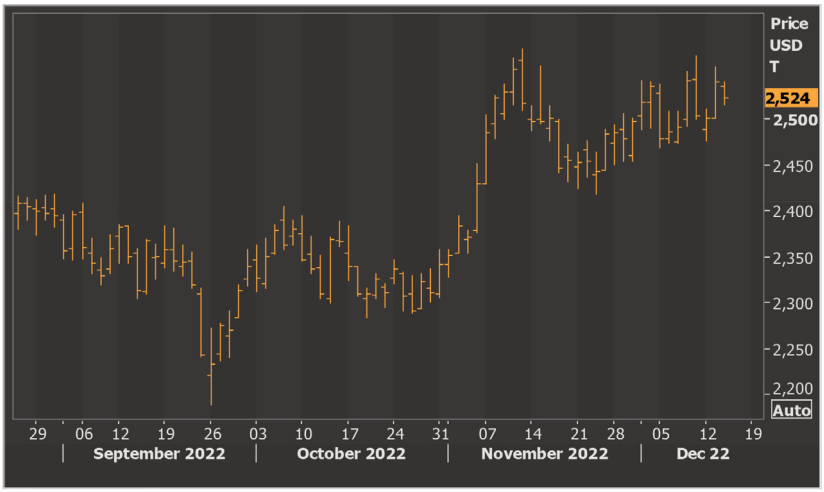


Chart courtesy Reuters

SOYBEANS

Can the US run out of beans?

After touching a multi-month high in late November, soybean prices suffered a nasty, one-session tumble (Chart 7), erasing a four-week rally in a flash. A sharp drop in soybean oil was the catalyst. Traders responded to a large cancellation of 2.3 million tonnes in the December 1 weekly US export report, and a contagion was anticipated for associated markets. Soybean meal was not affected at all and, actually, was just commencing a massive rally that saw meal prices rise about 15% in the weeks to follow (Chart 8).

Just to put the difference between oil and meal in perspective. Unlike meal, which comprises 70% of the global protein-meal market, oil makes up only 28% of the global vegetable-oil market. So a demand disaster in the meal market should certainly influence bean prices, but is far less meaningful when it happens in oil.

The large oil cancellation was a stark event, but in fact, oil exports have been dismal all year. The US has hardly sold any oil this marketing year. Sales for 2022-23 are only 7.3% of what they were last year at this time! Meal sales, on the other hand, are only 2.8% behind last year at this time. The selloff in beans on the oil news was a kneejerk reaction. Once traders realized that this was the case, the beans snapped back and resumed their uptrend.

In the meantime, US exports of soybeans are humming along at a fairly strong clip. Commitments to date stand at 42.47 million tonnes, higher than 40.8 million tonnes last year

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at this time. The USDA's forecast for 2022-23 is 55.66 million tonnes, below last year's final total of 58.72 million tonnes.

The USDA has taken a conservative approach to their 2022-23 final export estimate likely because shipments are 8.2% below last year at this time. However, shipments have been averaging about 2 million tonnes over the past few weeks. All else being equal, the USDA will have to increase its estimate for annual exports. In addition, shipments to China, the largest purchaser of US soybeans by far, are about equal to last year's.

As it is, the estimate for US ending stocks stands at 220 million bushels, or 5% of usage. That compares with 6% in the previous two seasons. So despite growing decent size crops over the past few years, carryover stocks remain near historic lows. And if the pace of exports is maintained, the ending-stock estimate will need to be revised even lower.

Of course, within a couple of months' time, Brazil and Argentina will enter the picture as their crops are harvested and become available for export. Brazilian output is expected to reach a record 152 million tonnes. Until then we see a tight market.

We recommend establishing long positions in March soybeans, currently trading at about $14.80 per bushel. Place initial sell stops at $14.25, close only. Alternatively, buy March soymeal, currently trading at $450 per tonne. Place initial stops at $415, close only.

[By Sholom Sanik, December 23, 2022]

Chart 7 – CBOT March soybeans

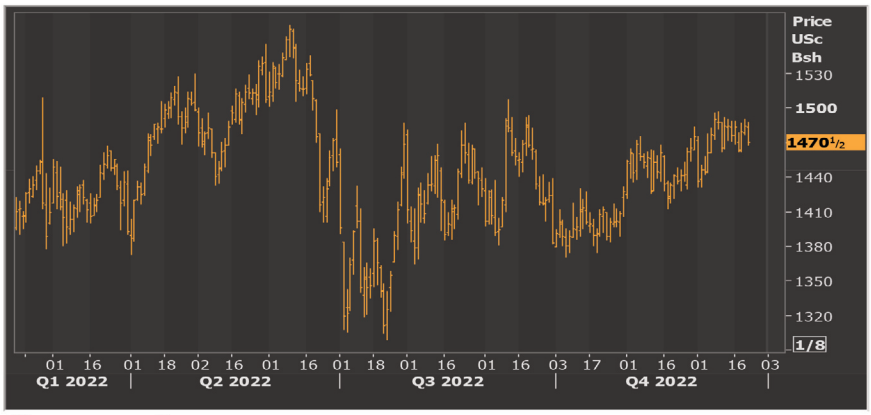


Chart courtesy Reuters

Chart 8 – CBOT March soybean meal

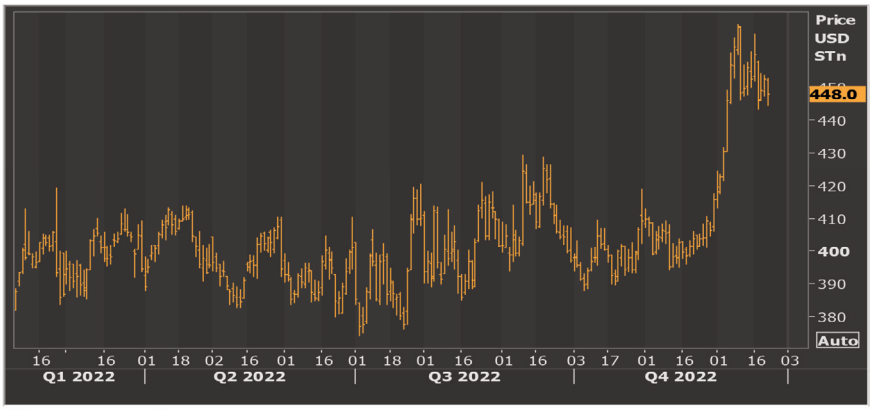


Chart courtesy Reuters

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