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Cocoa: Strong demand, but no match for supply

Cocoa prices have had a strong run since early September (Chart 1). Port arrivals in the Ivory Coast for the 2022-23 marketing year were languishing behind 2021-22 in the early part of the main-crop harvest. It seemed that we were looking at another soft year for West African production. That has changed.

The most recent data show arrivals at 1.416 million tonnes, 121,000 tonnes ahead of last year at this time. Of note, that is significantly higher than is typical at this juncture of the season. In the years of strong harvests, arrivals on this date averaged about 1.2 million tonnes.

At this point it would be reasonable to assume that earlier news stories of a dry Harmattan season that would affect moisture levels were overblown. The facts speak for themselves. With a couple of months remaining in the main-crop season and an entire mid-crop to come, we should be able to meet or beat the record set in 2020-21.

The other supply-side variable is Ghana. As we have discussed previously (see *Focus on Futures*, December 15), output for the world's second-largest producer was an absolute disaster in 2021-22. The absence of information is frustrating, but Cocobod, the government cocoa board, reported recently that its purchases reached 350,000 tonnes by December 15. That is up 150,000 tonnes, or 76%, from this time last year.

Of course, output cannot grow at that level all season long. Even if this pace of improvement mellows and we achieve, say, a 25% or 30% increase over last year, that would represent a jump of about 200,000 tonnes from last season. Output at 900,000 tonnes would represent Ghana's second-largest crop on record after the 1-million-tonne-plus crop seen in 2020-21. It is fair to say that Ghana is back to normal production.

On the demand side, Ivory Coast grindings have jumped 13.1% since the start of the 2022-23 marketing year compared with the same period a year earlier. Fourth-quarter grind statistics for Europe and North America will be released later this month. Analysts estimate that global grinding activity is growing by about 5% per annum.

Demand, as measured by grinding activity, is growing at a rate at the high end of the range of annual growth rates seen in recent years. Traders are obviously focusing on this side of the equation.

Bulls have found further support from the International Cocoa Organization's forecast for a 2022-23 production/consumption deficit of 306,000 tonnes. However, given the recent spike in production figures in both Ivory Coast and Ghana, we state with confidence that this forecast is extremely outdated. Rather, we believe that the market is at the very least balanced, if not in surplus.

We advise establishing short positions in July cocoa. Place initial buy stops at $2,800 per tonne, close only. We note that this recommendation likely breaks every basic rule of technical analysis in that the market is in a clearly defined uptrend. But as outlined above, we believe that supply/demand fundamentals do not support the massive rally we experienced and that prices will sooner or later reflect this reality.

[By Sholom Sanik, January 18, 2023]

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Chart 1 – ICE July cocoa

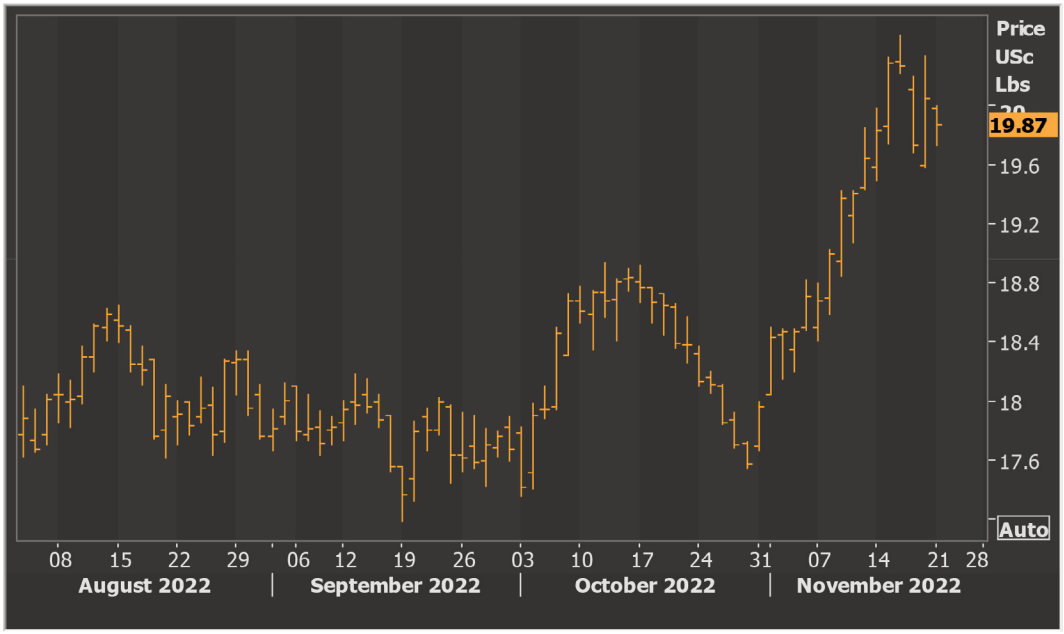


Chart courtesy Reuters

CORN

Supply vulnerability, but nobody's buying!

Corn prices received a boost from the January 12 USDA crop report. The bushel-per-acre (bpa) yield for the fully harvested 2022-23 crop was revised upwards by 1 bushel, to 173.3 bpa. Traders were expecting a small increase, to 172.5 bpa. Harvested area, however, was slashed by 1.6 million acres from the December estimate, or close to 2%. So even with the improved yield, the estimate for total output fell by 200 million bushels (5.09 million tonnes). March corn has rallied by as much as 30¢ per bushel since the evening before the report (Chart 2). Warranted?

That was the extent of the bullish data for the US. The demand side took a beating, with exports taking the brunt. Commitments stand at 22 million tonnes, down from 42 million tonnes at this time last year. Responding to this lethargic pace, the forecast for 2022-23 exports was revised downward by 150 million bushels (3.81 million tonnes), to 1.925 billion bushels (48.9 million tonnes), which is still only 22% below last year's final export figure. As illustrated, export commitments would seem to indicate that this estimate is far too generous. Unless there is a miraculous turnaround in new sales, that export forecast has not seen the last of downward revisions. Feed usage was lowered marginally, and ethanol was maintained at last month's estimate.

As a result of the huge cut in acreage, the ending-stock estimate was still below last month and below the average of analysts' guesstimates.

The missing link in US exports is China. As we have mentioned several times in the past, China came out of nowhere in 2020-21 with huge corn purchases from the US. There was some follow-through in 2021-22, but at the moment it seems that China has reverted to its near-self-sufficient status in corn. So far this marketing year, China has purchased 3.8 million tonnes from the US (shipped and unshipped) compared with 12.4 million tonnes last year at this time. Although the Chinese have been buyers of Brazilian corn, the volumes have been moderate.

Of note, Chinese output for 2022-23 was revised upwards to a record 277 million tonnes, up from 272 million tonnes and 260 million tonnes in 2021-22 and 2020-21, respectively. Motivation to buy corn abroad at prices that are still close to historical highs just may not exist.

Among the other principal exporting nations, the sup-

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ply side is vulnerable. Poor weather in South America has prompted estimates to be downgraded. The output estimate for Brazil was lowered in the crop report by 1 million tonnes, to 125 million tonnes. But Argentinean output was cut by 3 million tonnes, to 52 million tonnes, with some private forecasts talking about 45 million tonnes! And then there is Ukraine. Production is estimated at 27 million tonnes, down from 42 million tonnes in 2021-22.

So we have a bullish supply side pitted against a bearish demand side. Global production for 2022-23 is forecast to fall by 59 million tonnes from the previous year. Consumption is expected to fall by 36 million tonnes. Owing to last year's large carryout, ending stocks as a percentage of consumption will slip only slightly, to 25.43%, down from 25.46% in 2021-22.

We believe that barring further supply-side surprises out of South America, anemic US export demand will keep this market from any meaningful gains. We recommend establishing a short position in July corn, currently trading at about $6.70 per bushel. Place initial sell stops at $7.10, close only.

[By Sholom Sanik, January 19, 2023]

Chart 2 – CBOT July corn

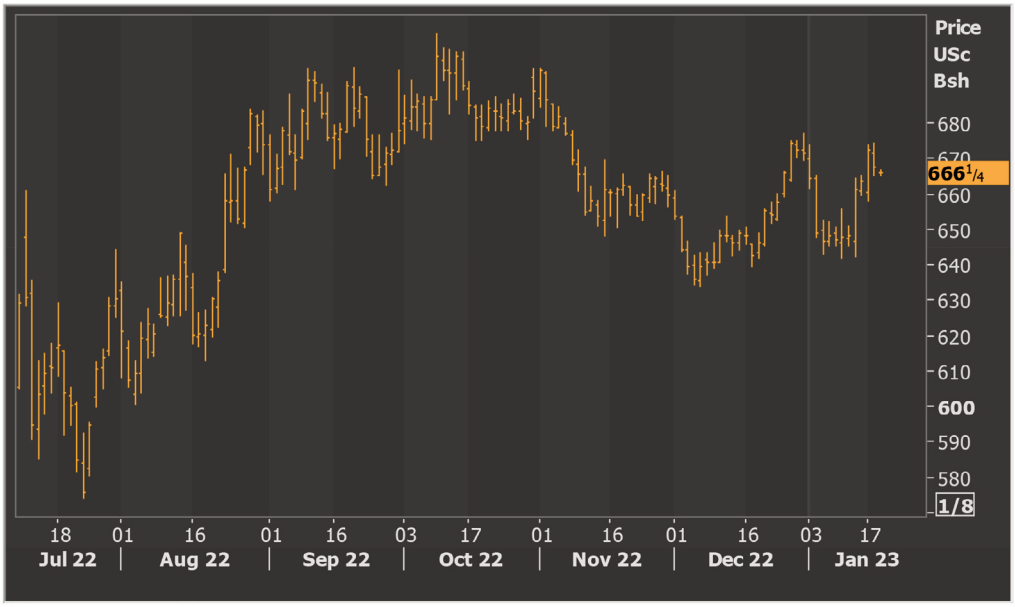


Chart courtesy Reuters

SUGAR

Brazil surprises, but output growth may have peaked

Sugar prices sprinted to five-year highs back in December. The exuberance was short-lived, however, and by month's end, prices had fallen back to the low end of the recent range. The market first consolidated and has since recovered back towards the highs (Chart 3).

Brazil

Brazilian sugar production for the outgoing season is estimated to reach about 36 million tonnes, about 3 million tonnes higher than early-season forecasts.

There is not much happening at this time of year in Brazil. The 2022-23 crushing season is winding down. The 2023-24 marketing year begins in April. The ethanol/sugar output ratio for the 2022-23 was about 55%/45%, which means that more sugar was produced than we had anticipated. Based on processing statistics earlier in the season, it seemed that the ratio would be closer to 60%/40%. However, with falling energy prices and strong sugar prices, processing favored sugar.

In early January, newly elected Brazilian president Luiz Inácio Lula da Silva extended an exemption on ethanol taxes

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for an additional two months. The move was deemed bearish, although it was not entirely clear why. More recently, state-owned Petrobras raised ethanol prices it pays to processors by 7%. The latter development is clearly bullish as it paves the way to an increase in ethanol output *vis-à-vis* sugar.

India

Whatever gains Brazil made over the past several months in terms of larger-than-anticipated output have been compromised by India. Indian output for its current marketing year, which began late last year, was forecast to meet the previous season's record of about 36 million tonnes. But poor yields have seen estimates drop sharply, to between 33 and 34 million tonnes.

Furthermore, in 2020-21 exports reached 11 million tonnes, almost double the average volume of recent years. However, the government controls tariff-free export, and there was much debate as to whether it would allow exporters to sell more than the 5.6 million tonnes already contracted for sales abroad. On January 26 – in response to lower production estimates – the government announced that it will probably not allow additional exports for the current marketing year.

With global consumption expected to rise to new highs, at about 177 million tonnes, there are no other important exporting nations that will have the capacity to pick up the slack. Thai output is being affected by the same weather that brought lower yields to India. Production is estimated at about 10 million tonnes, the same as the previous year. However, that is well below record output of 14 million tonnes achieved in 2018-19.

We believe that forecasts for a 2022-23 global production/consumption surplus of about 5 million tonnes are outdated because the poor yields in India have only recently come to light. In addition, the cap on Indian exports certainly tightens the market, at least in the short term. The global ending-stock figure may become bloated, but it's of no use if those supplies are not mobile. The Indian government could possibly lighten the restrictions, but that would happen at higher prices.

Perhaps the most important development is the increase in Brazilian ethanol prices, which should keep a lid on any growth in sugar output when the crushing season begins in April.

Our November 21 suggestion to liquidate May 18.50 calls on a close in March sugar below 19.50 was triggered. At this time, we advise purchasing July 20.00 calls, trading at about .60.

[By Sholom Sanik, January 27, 2023]

Chart 3 – ICE May sugar

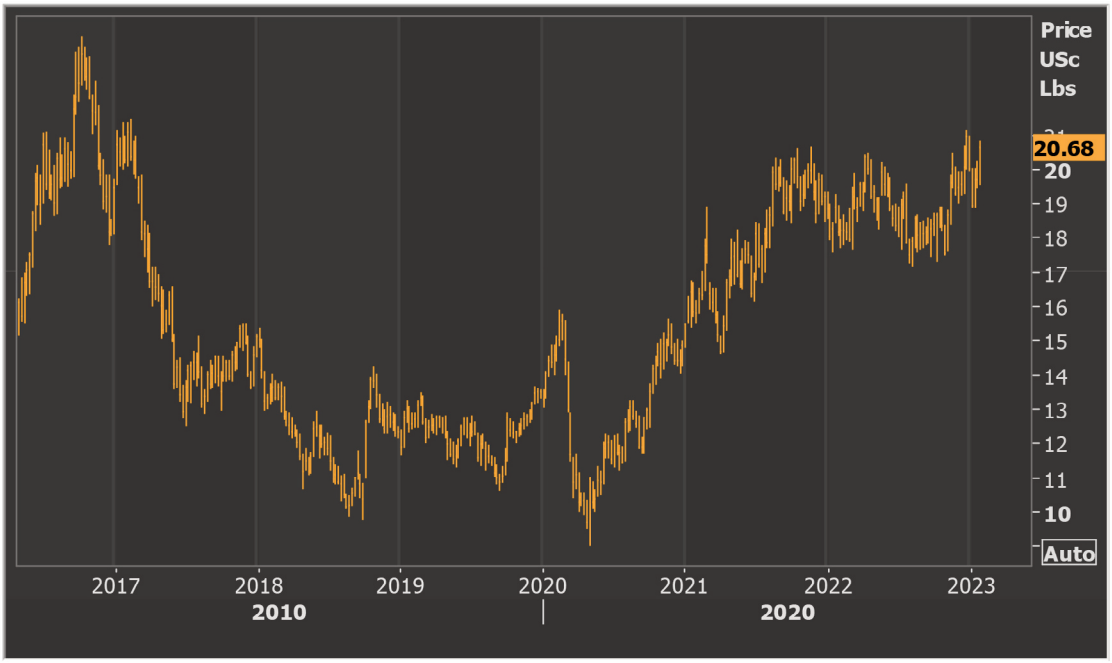


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SOYBEANS

Argentinean weather supports the soybean bull

Soybean prices have clawed their way back to near-recent highs. The primary focus has been on South American weather.

It's been very wet in Brazil, but for the moment, the estimate for production has not changed much. Output is still expected at a record of about 153 million tonnes. For Brazil, the issue has been a delayed harvest. As of the most recent update, 14% of the crop has been harvested, compared with 32% last year at this time and a five-year average of 20%. The only issue would be a delay in the volume of shipments.

In Argentina the problem is far more serious and poses longer-term fallout. Production in 2020-21 and 2021-22 was 46.2 million and 43.9 million tonnes, respectively. Early-season forecasts called for a bumper crop of 51 million tonnes and exports of 7.7 million tonnes. The January USDA crop report has already slashed those numbers to 45.5 million tonnes and 5.7 million tonnes, respectively.

The most recent credible update comes from the USDA attaché in Argentina. On January 31 it cut the estimate for the crop to 36 million tonnes!

That rather extraordinary estimate alone would alter the landscape for the global supply-demand balance dramatically. Over the past three years, global ending stocks averaged just over 27% of consumption. If we were to incorporate the USDA attaché's revision into the USDA balance sheet, that figure would drop to 24.7%.

Of course, the Argentinean share of global trade is dwarfed by both the US and Brazil. Nevertheless, it puts the whole market in a position that makes it vulnerable to any other unforeseen supply glitches.

On the demand side, US exports continue to hum along at a steady pace. Curiously, the USDA January crop report lowered its forecast for annual sales by 1.5 million tonnes from its December estimate, to 54.16 million tonnes.

We found this strange for several reasons. Commitments are still 2.4 million tonnes ahead of last year at this time. One of the bearish issues that threatened the outlook presented by strong commitments was that shipments were lagging. Over the past four weeks, however, total shipments to all destinations have been stronger than in the comparable period a year earlier. Furthermore, the slow harvest in Brazil, as mentioned earlier, should keep China buying US soybeans for longer than previously believed.

Considering these developing factors, we anticipate that the USDA will eventually need to raise the estimate for 2022-23 exports, which would result in a further tightening of the global balance sheet.

We are long March soybeans and March soybean meal as per our December 23 recommendation. Raise stops to $14.50 and $4.50, respectively.

[By Sholom Sanik, February 2, 2023]

Chart 4 – CBOT March soybeans



Chart courtesy Reuters

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Chart 5 – CBOT March soybean meal

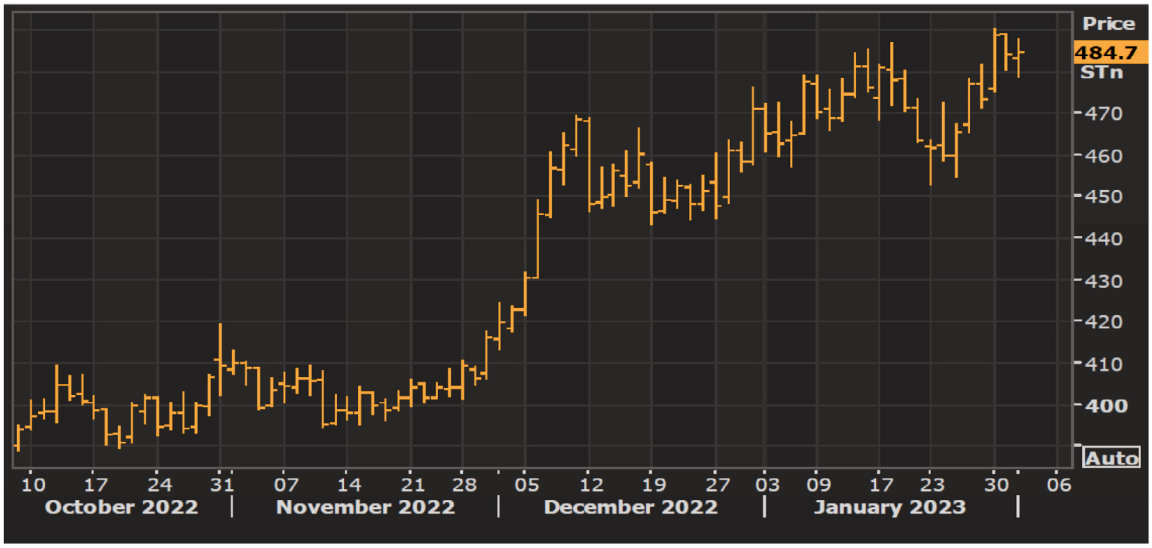


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