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Coffee: Waking up

The pandemic affected global coffee consumption only moderately. Roughly 25% of global coffee demand is attributed to out-of-home consumption. But despite the closure of restaurants and cafés, consumers continued to enjoy coffee at home. One industry group estimates that after only small increases in recent years, at-home coffee usage in the US grew by 5% in 2020 to compensate. According to the USDA's recently released biannual *Coffee: World Markets and Trade*, 2019-20 consumption was 162.8 million bags, down 1.2% from the previous marketing year, but is expected to bounce back to 165.4 million bags in 2020- 21. That covers the pandemic period, from mid-2020 until the present, and includes a forecast through mid-2021.

A bumper crop in Brazil, however, kept a lid on prices – at least until recently (Chart 1). Coffee prices began to rise in early November when it became obvious that dry weather would significantly affect the 2021-22 Arabica crop, which typically accounts for about 75% to 80% of total Brazilian output. As it is, the new Brazilian crop, which goes into harvest in May, is heading into the off year of its two-year cycle.

According to the USDA, total production for 2020-21 – which includes Arabica and Robusta beans – was a record 67.9 million bags. Some private estimates are as high as 70 million bags. Arabica output comprised 47.8 million bags of the total.

Looking ahead, however, according to long-time, well-regarded softs analyst Judith Ganes, the poor weather in Brazil has devasted crops for the upcoming 2021-22 harvest. While there have not been any specific forecasts for production, after a tour of key Arabica growing regions, Ms. Ganes concluded that some areas will have no beans to harvest at all, while others could lose as much as 50% of this past season's output totals.

Previous off-cycle harvests yielded between 50 and 55 million bags. If crop losses materialize as expected, the global balance could shift dramatically.

The USDA's balance sheet for 2020-21 shows a global production/consumption surplus of 10 million bags. Brazil typically grows close to 40% of the world's coffee beans. If consumption were to remain stable, a crop failure in Brazil could shift the 2021-22 balance to a 5- to 7-million-bag deficit.

While it may be a bit early to assume a catastrophic crop for Brazil, the combination of heading into the off year of the cycle and the possibility of even lower supplies if the dire predictions come to fruition could mean much higher prices down the road.

Establish long positions in May coffee. Place initial stops at $1.15 per pound, close only.

[By Sholom Sanik, December 29, 2021]

Chart 1 – ICE May coffee



Chart courtesy Reuters

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CORN

Up, up…and away?

The USDA's January crop report is out, and well, to say that it caught everybody off guard is an understatement. There had been some talk that the bushel-per-acre yield (bpa) for the recently harvested US corn crop would see a bit of a downward revision. The average of analysts' guesstimates was 175.2 bpa, which would have been down from the 175.8 bpa December estimate. The actual figure came in at 172 bpa. Combined with a small downward revision in planted acres, the estimate for 2020-21 production fell by 325 million bushels, which sparked a rare limit-up move for corn futures (Chart 2).

Working through the report, there were other significant items. The supply-side news among major producers was mostly bullish. Dry weather in South America prompted downward revisions for Brazil and Argentina. Brazilian output was revised down by 1 million tonnes from the December estimate, to 109 million tonnes, and Argentina fell by 1.5 million tonnes, to 47.5 million tonnes. That compares with 102 million tonnes and 51 million tonnes in 2019-20, respectively. Argentinian exports are expected to dip, but Brazilian exports, still with a larger crop than this past season, are forecast to increase by 4 million tonnes over 2019-20.

On the US demand side, all three key demand categories for the US were revised lower. The feed estimate was down by 50 million bushels, while ethanol and export demand were each cut by 100 million bushels.

Ethanol

In past discussions – see *Focus on Futures*, November 19, 2020 – we wondered about the optimistic view the USDA had taken on ethanol demand for 2020-21. The downward revision in the January crop report, based on disappearance data from the USDA's Grain Crushings and Co-Products Production report, represents usage over the past several months and indicates a more realistic assessment of demand. Over the same period, EIA figures show that production has fallen. Even with lower output, Chart 3 shows a build in US ethanol stocks.

Exports

Traders have become comfortable with the birth of the new paradigm of China's becoming an importer of US corn. And indeed, the totals for the marketing year, present impressive statistics. In 2019-20 China bought 60,000 tonnes of corn from the US, or basically nothing. Thus far in 2020-21, shipped and unshipped sales stand at 11.77 million tonnes. Consider, however, that 75% of the total was contracted for purchase before the 2020-21 marketing year even began. The last formidable weekly tally was in September, early in the marketing year. Purchases have since slowed down to a trickle (Chart 4).

The buying spree was attributed, at least in part, to a poor Chinese crop, which required imports to compensate. Curiously, the USDA has maintained its estimate for the recently harvested Chinese crop at 260.67 million tonnes, which was actually a small uptick from last month's estimate and virtually the same as 2019-20 output. Rather, in all likelihood, the rush of purchases was part of the fulfilment of the Chinese government's commitment to the trade agreement, signed with the US in January 2020, to purchase agricultural products. Once met, China should return to its historical stature of being self-sufficient in corn, which would set Chinese purchases from the US back to zero. True, 2020-21 Chinese ending stocks are expected to fall to 66% of usage, down from 75% in recent years, but it remains a staggering inventory level.

We believe that the USDA's unexpected downward revision of global sales by 100 million bushels could reflect the end of Chinese imports of US corn.

Nevertheless, the deep cut in the US production estimate was larger than the 250-million-bushel drop in the demand estimate, which served to lower the ending-stock forecast once again. US ending stocks as a percentage of consumption will fall to 10.6% from the December estimate of 11.5%. That compares with 13.7% in 2019-20 and 15.5% in the pre-pandemic/pre-trade-war season of 2018-19 (Chart 5).

Is that low for the US? Not particularly. As can be seen in Chart 5, US ending stocks fell to a dangerously low level of 5.4% of consumption in 2010-11, rose the next year to 7.9%, and then dropped back to 6.8%. Only then, in 2013, did corn prices spike to $8 per bushel. We do not believe that we are in a comparable environment.

Brazil and Argentina were not exporters of consequence until several years ago. Combined, these two countries now export more corn than the US. Yes, South America is having some weather problems, but clearly the US is no longer the exporter of last resort.

Global ending stocks have slipped over the past few years (Chart 6). However, with the USDA estimate at 24.5% of consumption for 2020-21, we are nowhere near what could be considered worrisome tightness in historical terms.

US farmers are expected to reduce corn acreage by about 1% this spring. Chart 7 shows the ratio between prices of new-crop soybeans and new-crop corn heavily favoring soybean profitability. Traders will therefore soon begin to focus on acreage updates to see just how

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much corn area will be diverted to soybeans.

Our focus has been on what we still believe to be fleeting Chinese imports. We did not see the sharp drop in the US crop coming. With the January revision, the estimate has fallen by 700 million bushels, or close to 5%, since the early harvest period. Mercifully, we were stopped out of our short position at $4.35 per bushel, when the market was about $1 below current levels.

Stand aside, but stay tuned.

[By Sholom Sanik, January 15, 2021]

Chart 2 – CBOT March corn

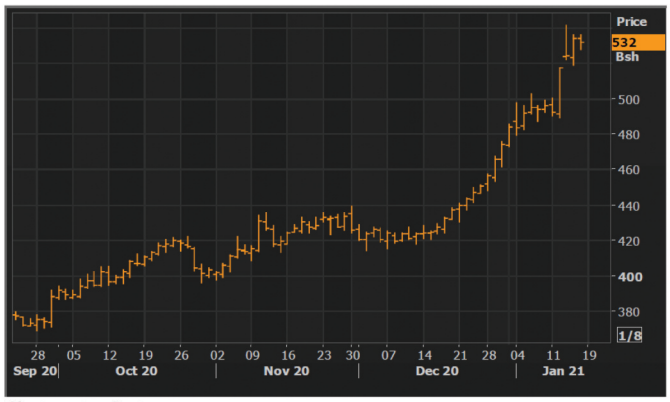


Chart courtesy Reuters

Chart 3 – US ethanol stocks (000s of barrels)

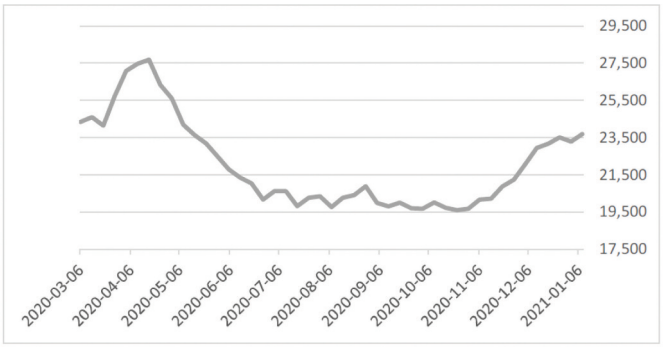


Chart source: EIA

Chart 4 – Weekly Chinese imports of US corn (000s of tonnes)

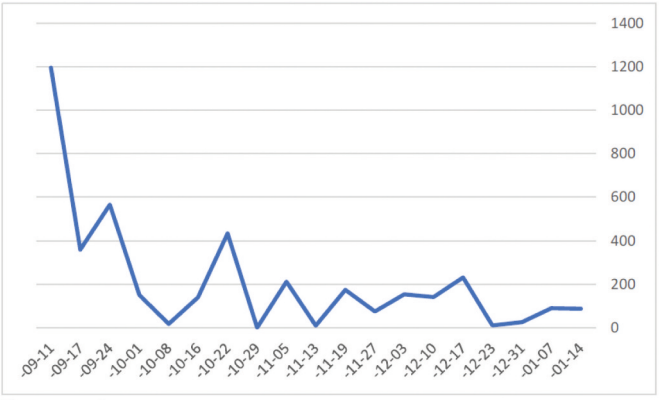


Chart source: Reuters

Chart 5 – US corn ending stocks

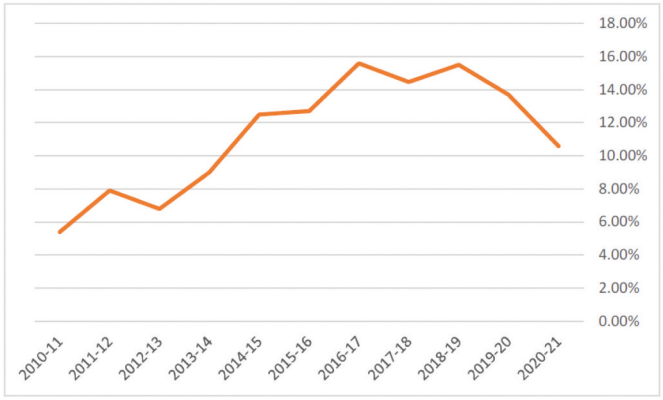


Chart source: USDA

Chart 6 – Global corn ending stocks

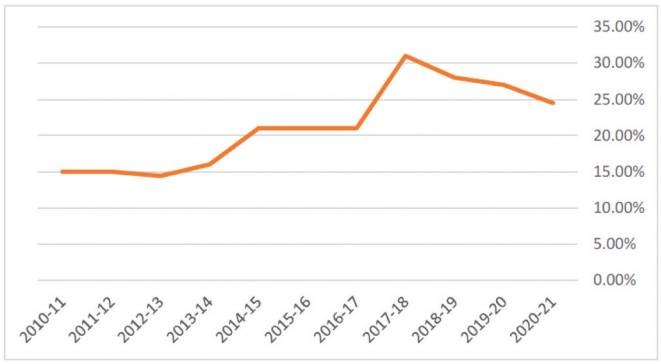


Chart source: USDA

Chart 7 – November soybeans/December corn ratio



Chart courtesy Reuters

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COTTON

US output disappoints, China restocks

Headed into the January 12 monthly USDA crop report, cotton prices had rallied more than 50% from their April 2020 bottom. The results of the report sparked yet another new high for the move to two-year highs. The market continues to advance (Chart 8).

Highlights of the report included a further cut to US yields for the recently harvested 2020-21 crop. As recently as November, the USDA was forecasting record yields of 911 pounds per acre. The December estimate had already been slashed to 850 pounds, so the January revision down to 825 pounds in itself was not startling. However, the abandonment rate was increased as well, from 74.3% of planted acreage to 72%. For comparison, the 2019-20 abandonment rate was 85.5%. All told, output is now estimated 14.95 million bales, down from a season-high forecast of over 17 million bales and sharply below lower 2019-20 production of 19.9 million bales.

On the international front, Chinese output was revised down by 1 million bales, to 85.37 million bales. Pakistan is a key importer of cotton and has seen its crops dwindle over the past several years. In 2017-18, production was over 8 million bales. With this month's downward revision, output is estimated at 4.3 million bales. Weather conditions were disastrous. Private forecasters see output below 4 million bales, so look for further revisions.

Still on the supply side, Brazilian output is estimated at 12 million bales, down from 13.78 million bales in 2019-20 because of lower planted area. Some analysts believe that is on the low side. Unlike the bulk of the other Brazilian crops, the cotton planting season begins in December. The USDA's estimate has not changed since the 2020-21 balance sheet was first published in May. With prices rising, it is very likely that planted area grew.

Cotton growing can be very profitable in Brazil. Consider that national per-acre yields, at 1,600 pounds per acre, are virtually double what they are in the US. The USDA's initial estimate came at a time when world prices were 50¢ per pound. With prices at 80¢ per pound, the economics of planting cotton may well have inspired farmers to plant more.

On the demand side, Chinese purchases from the US have remained steady. Save for a couple of soft weeks during the holiday period, weekly commitments have remained strong (Chart 9). To date for the 2020-21 marketing year, China has purchased 4.354 million bales of US cotton (shipped and unshipped), more than double the 1.912 million bales last year at this time. As a result, the USDA cut the estimate for US ending stocks, from 5.7 million bales, or 33% of consumption, to 4.6 million bales, or 26% of consumption. That compares with 41% in 2019-20.

Global ending stocks were revised down slightly but remain stubbornly high at 83.23% of consumption. Traders are obviously looking forward to a time when retail clothing demand will return to normal when the pandemic passes. The St. Louis Fed's Advance Clothing and Clothing Accessory Store indicator (Chart 10) continues to show that after a huge recovery, retail sales have plateaued at a level well below the pre-pandemic era. (The indicator is current through the end of December, including bricks-and-mortar stores and e-commerce for those stores that have an online imprint.)

While ending stocks have indeed drifted lower because of Chinese restocking, it may be some time before the retail sector will normalize sufficiently to justify a continuation of Chinese imports at the pace we've been seeing.

As illustrated, most supply/demand developments have been bullish. Being focused mostly on very high global ending stocks, we have been trading this market from the short side. We were stopped out of our short position at 75¢ per pound, basis March, as per our November 20 recommendation.

Stand aside but stay tuned.

[By Sholom Sanik, January 22, 2021]

Chart 8 – ICE March cotton



Chart courtesy Reuters

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Chart 9 – Weekly Chinese imports of US cotton (000s of bales)

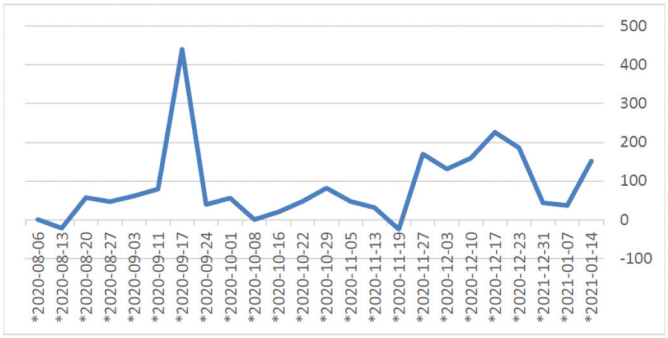


Chart source: Reuters

Chart 10 – St. Louis Fed's Advance Retail Sales: Clothing and Clothing Accessory Stores (millions of dollars)

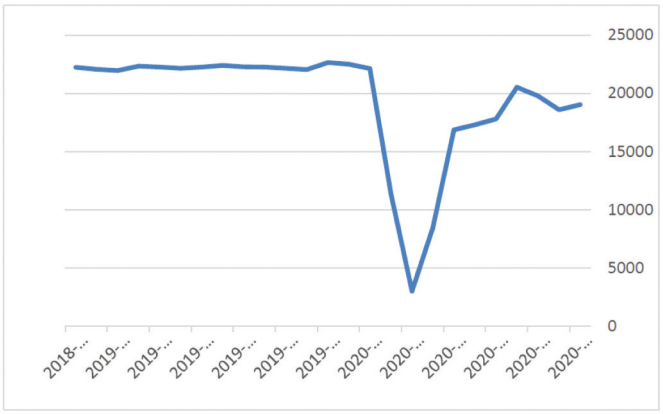


Chart source: St. Louis Fed

COCOA

Behind the statistics

The cocoa market was an early entry to the commodity bull market. This past November, prices spiked by close to $700 per tonne (Chart 11). Since then, however, cocoa prices have languished behind the broader commodity markets (Chart 12).

The November rally was sparked when chocolate manufacturer Hershey balked at paying the $400-per-tonne premium to farmers, known as the "living income differential" (LID). Instead, the company secured its intermediate-term supply needs by buying December futures at the ICE with the intention of taking delivery. This in turn would deplete warehouse stocks. Eventually, Hershey secured a truce with the Ivory Coast and Ghana by agreeing to pay half the LID. The company would continue to purchase beans directly from the origin countries. As a result, prices retreated.

On the demand side, a study of recently released grind data for the fourth quarter shows a mixed picture. The North American grind was the best performer, growing by 6.95%, year over year. This, however, comes after two quarters of losses, and more significantly, it is the smallest among the four major processing regions. The North America grind is only about 35% the size of the EU grind.

The EU grind for the period was 3.1% lower, with Asia down 4.2%. Ivory Coast grindings grew by about 4%, and it is now by far the largest processing region. Combined, the global grind was actually positive for the quarter.

Normally, the grind is considered the barometer for demand, and as such, this could be construed as bullish. But we believe that processors may have been a bit exuberant, and end-use demand remains sluggish. For example, Barry Callebaut, one of the largest manufacturers of cocoa products and chocolate, has seen sales drop by 4.3% over the past two quarters. Despite the pact reached last year between European and American buyers, unsold beans are piling up in the Ivory Coast. It is estimated that 200,000 tonnes of main-crop beans – an unusually high number for this time of year – that have been transported to port warehouses remain unsold.

While powder prices have been very strong, butter is the main ingredient in chocolate manufacturing. The price that grinders can command for butter will be the ultimate determinant of incentive for how many beans they will buy. As seen in Chart 13, butter prices remain anemic.

Ivory Coast port arrivals are running 5.8%, or about 80,000 tonnes, behind last year's pace. Ghana is slightly ahead of last year. Part of the reason for slow arrivals is not necessarily poor crop conditions; rather, farmers in some growing regions are in no hurry to harvest pods while unsold beans are piling up in warehouses. Eventually they will harvest, and we anticipate that we will soon see the gap close between this season's arrivals and last year's.

Weather for the mid-crop has been favorable, and while it is too early for any accurate estimates, there is no reason to assume that, by the time the marketing year closes in September, output will not be similar to the bumper crops we've seen over the past two years.

As illustrated, the traditional yardsticks for measuring both supply and demand for this market may not be accurate in this environment. There have not been any forecasts for the global production/consumption balance for 2020-21, but we suspect that we are building a substantial surplus.

We recommend establishing a short position in May cocoa, currently trading around $2,475 per tonne. Place initial buy stop at $2,600, close only.

[By Sholom Sanik, January 28, 2021]

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Chart 11 – ICE May cocoa

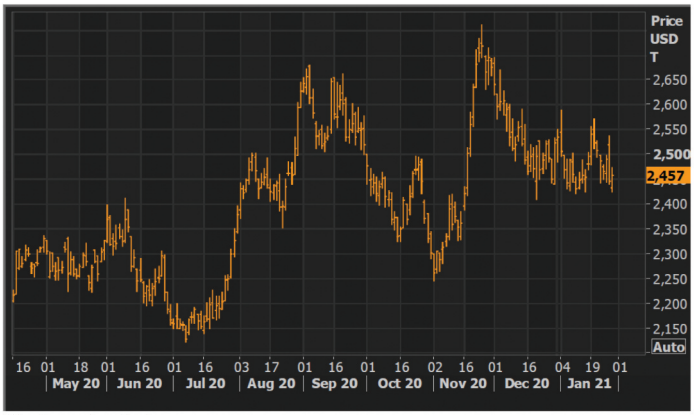


Chart: courtesy Reuters

Chart 12 – Bloomberg Commodity Index/nearest contract cocoa ratio

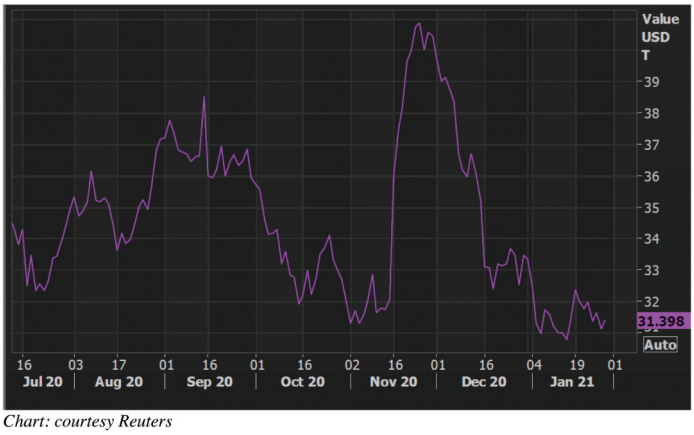


Chart: courtesy Reuters

Chart 13 – Cocoa butter and powder prices

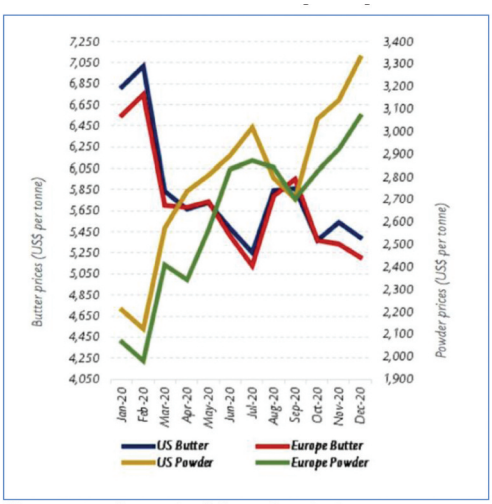


Chart: courtesy International Cocoa Organization

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