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Sugar: Sweet no longer?

In the space of one week, the sugar market has erased half of this year's gains (Chart 1). With July going off the board, bulls have been liquidating their long positions, and apparently not rolling those positions forward. Open interest has fallen by more than 100,000 contracts, or about 10% (Chart 2). Have the supply/demand fundamentals changed?

Three months into the Brazilian crushing season, output levels are living up to their forecasts. For the second half of June, the sugar/ethanol ratio was 48.95%, the highest bi-weekly number so far this season. Actual volume of sugar production was down from the previous period, however, because mills lost several days of crushing owing to wet weather. At this rate, total Brazilian production for the 2023-24 marketing year will be about 39 million tonnes, the second highest on record after 2020-21. This estimate is slightly higher than previous estimates, but is not shockingly fresh news.

The situation in India has been the catalyst for the bull run. One new development came on June 12 when the Indian government announced that it will not allow exports until sometime in the first half of 2024. There are two concerns that prompted the government to adopt this restrictive measure.

First, this year's output is expected to fall by about 10%. The sales of 11 million tonnes abroad in the 2021-22 marketing year has drawn stocks down to about 6 million tonnes, their lowest level in many years. Over the past five years, ending stocks averaged about 15 million tonnes. In 2022-23, before weather forced the early closure of mills, the sharp drop in output was not anticipated. Exports flowed freely until they reached 6 million tonnes, at which point the government halted all sales abroad.

Then the government began to worry about what lies ahead. The new, 2023-24 crop, which is harvested and crushed starting in November could be affected by El Niño, which would cause drought conditions. So, there is no assurance that the drop in output levels is going to be a one-year, anomalous event.

The Indian export restriction was definitely a significant item because it means that the burden of global trade falls squarely on the shoulders of Brazil. As illustrated, Brazilian output is meeting expectations, and the bump in production of 4 to 5 million tonnes above last year will compensate India's absence from global trade for the next six to nine months. However, it will not create a bounty for the global supply position as long as India maintains its no-export policy.

In fact, before the Indian situation became known, The International Sugar Organization started the season with a forecast for a production/consumption forecast of 6.2 million tonnes. In February it cut that estimate to 4.5 million tonnes, and in May revised that to a near balance. As recently as June 20, one private forecaster said there would be a deficit of over 1 million tonnes.

Thailand, the world's second-largest exporter behind Brazil, has also seen drought reduce output for 2022-23. And going forward, whatever effect El Niño will have on India could be shared by Thailand.

We view this devastating slide in prices as a correction in a long-term bull market. On May 25 we suggested rolling July call options into October 27¢ calls, which were trading at 1.30 at the time. They have lost most of their value. At this time, we suggest buying March 25¢ calls, currently trading at about .90.

[By Sholom Sanik, June 30, 2023]

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Chart 1 – ICE October sugar

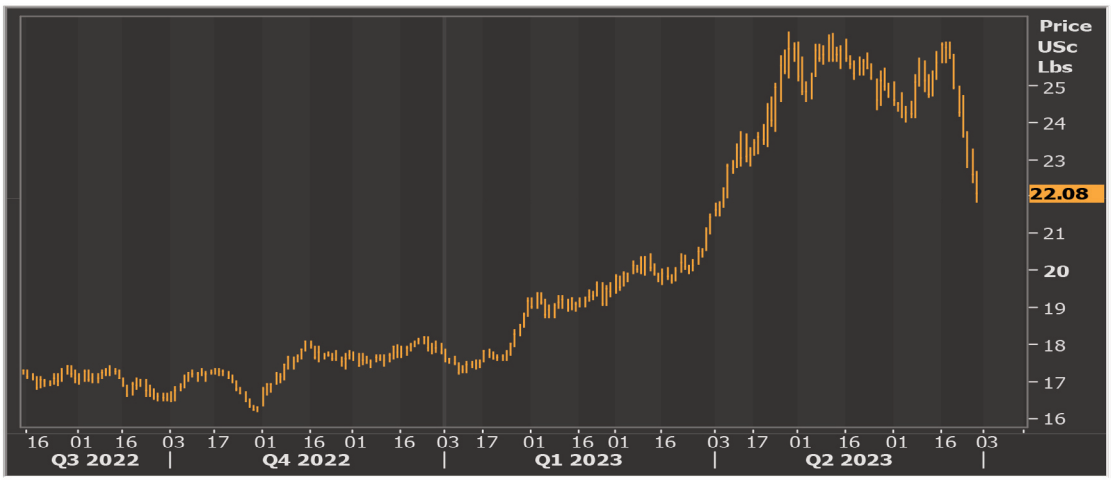


Chart courtesy Reuters

Chart 2 – ICE sugar open interest

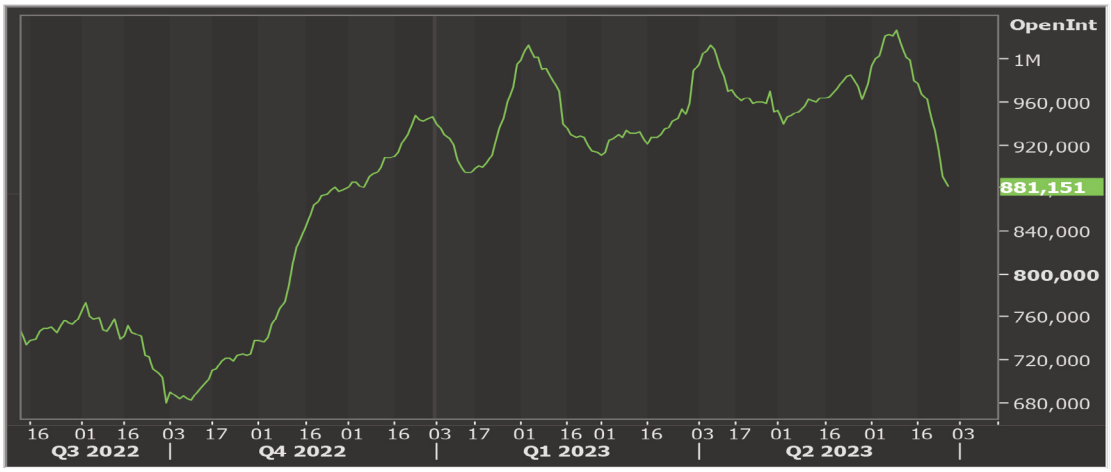


Chart courtesy Reuters

SOYBEANS

Historic tightness building

In the annals of surprising USDA reports, the June 30 planting update may very well rate among the most surprising. March 30 planting intentions estimated that US farmers would plant 87.505 million acres of soybeans. Heading into the report, the average range of analysts' estimates was 87 to 88.5 million acres. In other words, there was not even a hint that there would be much change from the March estimate. The actual figure came in at 83.5 million acres. The revision was widespread, with 20 states seeing the planted-acre forecast falling from the initial estimate.

We are not aware of any reasonable explanations. In fact, logic may have dictated otherwise. We are just closing down a marketing year that can be described as a disaster for US corn exporters, but the estimate for corn acres was much higher than expected (more on that in a subsequent article).

Soybeans, on the other hand, had fairly decent demand from abroad. While total sales to all destinations are below last year's, shipments to China – the US farmer's largest customer – are 2.5 million tonnes *above* last year at this time. And as we have discussed many times in the past, demand from China will remain constant because it grows only a fraction of its soybean requirements.

Overshadowed by the acreage shock, quarterly stocks, which are released concurrently with the acreage update and

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are an indication of domestic demand, were below analysts' expectations.

To fully appreciate the significance of a crop that will be grown on 3.5 million acres less than anticipated, consider the impact on the 2023-24 US balance sheet.

The USDA's initial estimate of a 52-bushel-per-acre (bpa) yield, which would tie the record set in 2016-17, is most likely not achievable. The first crop condition report in early June showed the good-to-excellent portion of the crop at 62%. That figure has fallen each week and now stands at 50%, down from 63% at this time last year. Given current conditions, one analyst estimates the yield estimate could fall to about 50 bpa.

The acreage report did not revise the June crop report's harvested/planted-acre ratio of 99%. A heady assumption. But even so, using 83.5 million acres harvested at that ratio with a yield of 50 bpa means that the crop estimate will drop from 4.5 billion bushels (122.74 million tonnes) to 4.133 billion bushels (112 million tonnes).

With that supply-side arithmetic pitted against the demand estimates in the June crop report, the 350-million-bushel (9.52 million tonnes) 2023-24 estimated carryout is, well, gone and then some. Negative ending stocks? Of course, you cannot crush or export what does not exist, so the demand numbers will have to be revised downwards. Any way you look at it, though, we are staring historic tightness right in the face.

November new-crop soybean prices ran up in mid-June as crop conditions deteriorated. Prices fell sharply in the days leading into the report and subsequently rallied back to the highs (Chart 3). If the supply picture we painted materializes, the vulnerability, as illustrated, is indisputable. Prices should be volatile before the release of the July 12 yield estimate.

November soybeans are currently trading at about $13.50 per bushel. We suggest establishing a long position on a pullback of 30 to 40 per bushel. If filled, place initial stops at $12.50, close only.

[By Sholom Sanik, July 4, 2023]

Chart 3 – CBOT November soybeans

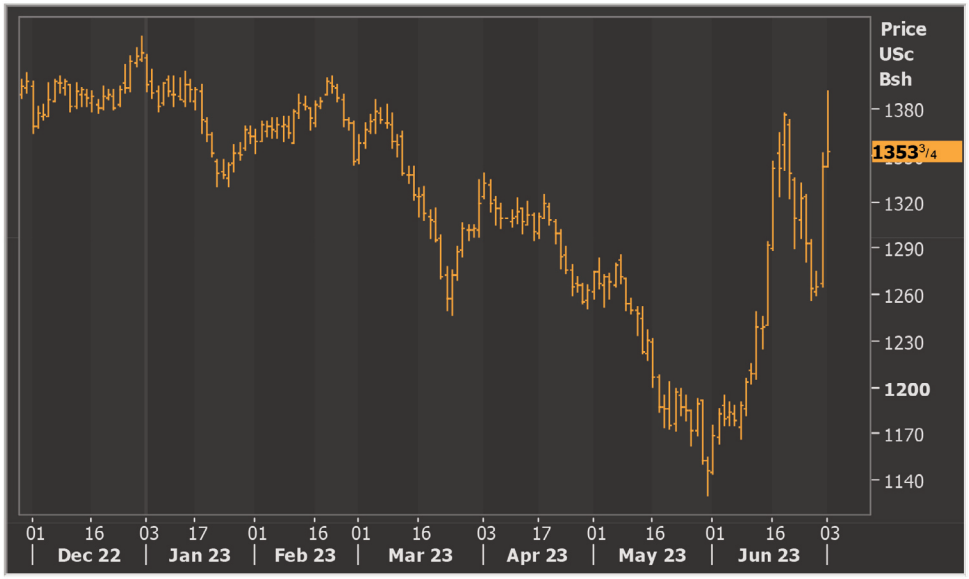


Chart courtesy Reuters

CORN

Acres galore

Until mid-May, 2023-24 new-crop corn prices were in a six-month-long, precipitous decline. Export demand was weak. The crop was being planted in record time, so prospects for a bountiful crop at the end of the summer loomed large. Then drought conditions began to appear in the Midwest, and the market shot up to eight-month highs (Chart 4). Then came some rain and the June 30 acreage report, and in what seemed like just a flash – seven trading sessions – the entire rally was gone with fresh lows for the season.

The June 30 USDA acreage and quarterly stocks reports were chock full of surprises for the corn market – bearish and bullish, respectively.

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Most notable was the revised planted area estimate. The March 30 planting intentions had already left us wondering why US farmers were planting 92 million acres of corn – up from 88.6 million acres in 2022-23 – particularly since export demand was so weak. So it was quite alarming to see the more recent survey indicate that even more corn acres were planted. The average of analysts' estimates was 91.853 million acres, but the actual figure came in at 94.096 million acres.

The estimate for harvested-to-planted acres rose slightly to 91.7%. Given the USDA's yield estimates, the unexpected acres could add about 400 million bushels to the crop and would thereby fling the US 2023-24 carryout to more than 17% of consumption, well above the average of less than 10% in recent years. All else being equal, it appeared to be an open-and-shut case for the bear side.

The only problem is that there are other factors to consider. First, the USDA's current yield estimate is 181.5 bushels per acre (bpa) and was issued before the crop was even fully planted. It is fair to say that given the early poor weather conditions, the forecast for record yields may not be realistic. In 2022-23 the yield was only 173.3 bpa, and in 2021-22 it was 176.6 bpa. As of the most recent weekly progress report, the good-to-excellent portion stands at 51%, down from an early-season high of 69%.

So if we were generous and used 176.6 bpa as "the more likely outcome," the extra 2 million acres tacked on to the crop in the June 30 acreage report would not increase the crop size at all from the 15.265-billion-bushel estimate in the June 10 crop report.

Then there are other factors to consider. It would seem that domestic feed demand has been stronger than anticipated. Inventories as of June 1 were estimated at 4.106 billion bushels. The average of analysts' guesstimates was 4.255 billion bushels. It was not quite as shocking as some of the other items contained in these reports, for corn and other commodities, because it was inside the guesstimate range of 4.086 and 4.41 billion bushels. Still, it was a substantial miss. If the USDA lowers its yield estimate, a *downward revision* of 2022-23 ending stocks is to be expected in the July 12 crop report.

To be clear, we are not making the argument that there is any tightness. The ending-stock figure for the US should remain above the average of the past few years.

However, there is a wild card in export demand. Bear in mind that it was an off year for US exports. Indeed, forward sales for new-crop corn remains sluggish at 3.6 million tonnes, compared with 16 million tonnes and 5.5 million tonnes at this time of year in 2021-22 and 2022-23, respectively. But it does mean that there is something to monitor carefully. Should there be indications that foreign buyers will return to "normal" purchasing patterns, the landscape could change in a hurry.

For the moment, stand aside but stay tuned.

[By Sholom Sanik, July 7, 2023]

Chart 4 – CBOT December corn

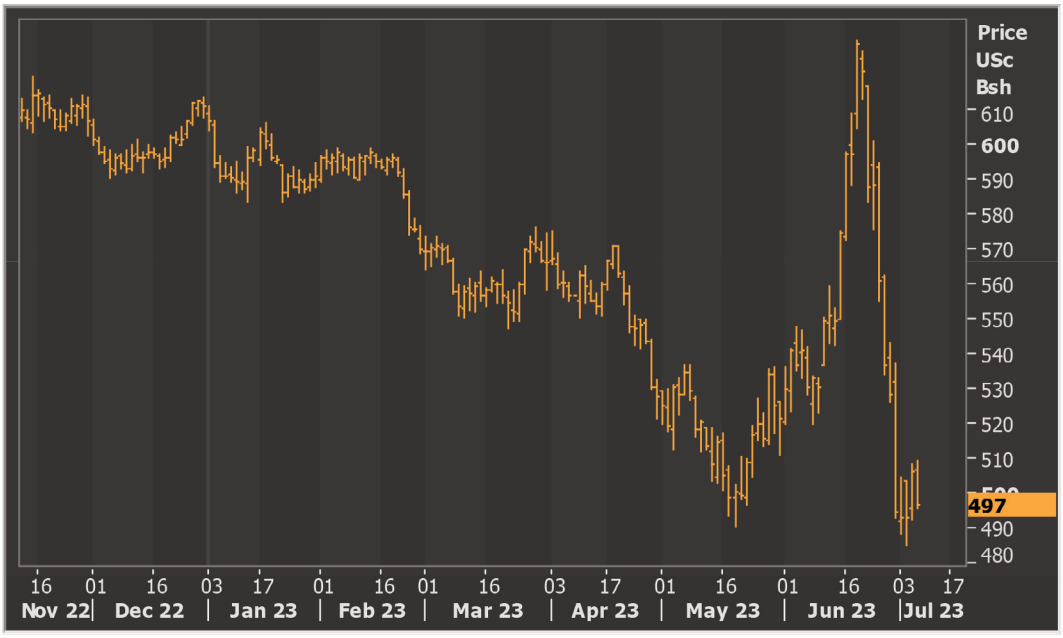


Chart courtesy Reuters

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COCOA

An exhausted bull

The 2022-23 Ivory Coast crop began in fine form. For most of the main-crop season, output was running ahead of the previous year. By February, however, the tail-end of the main-crop and the start of the mid-crop saw excessive precipitation, which brought humidity, resulting in black-pod disease. Port arrivals shifted from 100,000 tonnes above last year to 100,000 tonnes *below*.

The mid-crop, however, seems to be performing far better than the main-crop. Save for one week, in each weekly reporting period since the beginning of May, arrivals have either been equal to or higher than the previous season. While we're still running 100,000 tonnes below last year, the gap is narrowing. Chart 5 shows that at the end of April, arrivals were lagging 2021-22 by 8%, but we're only 4% behind now. Should this continue, the "disaster" crop that the street is trading off is, well, hardly a disaster.

In 2020-21, Ghana, the world's second-largest producer had a crop failure. Total output reached only 683,000 tonnes, down from 1 million tonnes a year earlier. Information for Ghana is hard to come by. It's been two months since there have been any crop estimates. At the time, arrivals were 576,000 tonnes. That was about 10% above 2021-22. The International Cocoa Organization (ICCO) forecasts that production will rise to 750,000 tonnes. The weather conditions are not too dissimilar for West African cocoa producers, so it is not a stretch to assume that the mid-crop in Ghana will exceed expectations as well.

On the demand side, for several years now, a pattern has developed. EU grinding is flat, and North America is eroding. Asia is growing moderately. All the growth is in the main principal origin country, Ivory Coast. According to the ICCO, global grinding will grow about 1.5% in 2022-23.

In June, the ICCO forecast a global production/consumption deficit of 142,000 tonnes. That was up from its previous forecast for a deficit 60,000 tonnes. We believe that this estimate was calculated at a moment when Ivory Coast output looked bleakest. As illustrated, the hard facts indicate that mid-crop prospects have improved.

In summary, since the beginning of the marketing year prices have risen by 50% (Chart 6). The bulk of the rally was sparked by the possibility of an output crisis in the Ivory Coast. At 2.238 million tonnes with two months remaining in the marketing year to pad that total, where's the crisis?

Furthermore, as of the most recent weekly reporting period, commodity funds have actually added to their position over the past few weeks to hold a huge net-long of close to 50,000 contracts. We do not believe that the supply/demand fundamentals still warrant such exuberance. Once this becomes evident, a strong liquidation phase should follow.

We understand that the presentation of the above arguments and the ensuing recommendation will be nothing short of sacrilegious in the technical analysis world – going against a picture-perfect bullish chart.

Nonetheless, we suggest establishing a short position in December cocoa, currently trading at about $3,350 per tonne. Place initial stops at $3,500, close only.

[By Sholom Sanik, July 12, 2023]

Chart 5 – 2022-23 Ivory Coast arrivals *vis-à-vis* 2021-22

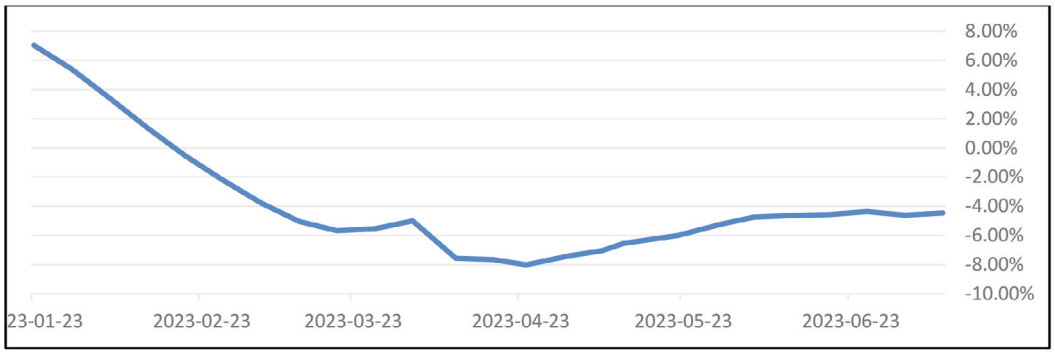


Chart source: Reuters

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Chart 6 – 2022-23 ICE December cocoa

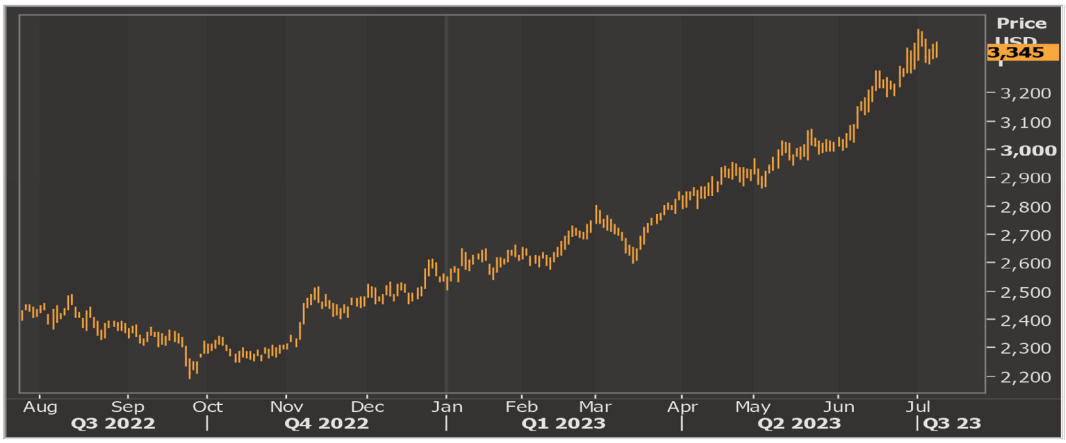


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