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Sugar: It's all about Brazil

Brazil's cane crop is shared between the sugar and ethanol industries. With Brazil's status as the world's largest producer and exporter of sugar, a shift in the ethanol/sugar ratio of just a few percentage points can materially affect the amount of sugar available for export. Like petroleum, Brazilian ethanol prices have spiked and are up about 60% in 2021 (Chart 1). Sugar prices, in turn, rallied as ethanol producers began to divert more cane to ethanol.

For most of this past season, sugar was in favor with crushers. Late in the season, processors began paring back on sugar production, but the ethanol/sugar output ratio was still quite low at 56.3/43.7% compared with the historical norm of well over 60% for ethanol. Conventional wisdom dictated that sugar production would suffer from high ethanol prices and provided the backdrop for the rally in sugar prices, even though Brazilian mills maintained the lowest ethanol/sugar output ratio we've seen in years.

Until July, the rally in sugar was partly the result of anticipation of a shift to ethanol and partly participation in the broad bull market in commodity markets. And although mills were determined to produce sugar in greater proportion to ethanol than we've seen in years (which was the reason we were bearish all along), the July frosts would eventually see sugar output fall by about 3 million tonnes. This would put total output for the marketing year down about 10% from the record amount produced the previous season.

Brazilian exports are by far the largest in the world. In recent years sugar exports averaged about 40% of global trade, so what happens in Brazil could single-handedly affect the entire market. Indeed, in August, the International Sugar Organization forecast the global production/consumption deficit at 3.8 million tonnes. That compares with its pre-frost estimate of 2.6 million tonnes. Some private analysts estimate a much larger deficit.

Were it not for India, the market would be even tighter. Indian exports reached a record 7.2 million tonnes, even though the government suspended its export subsidy program in mid-season. With world sugar prices at their highest level in years, providing an incentive to export was no longer necessary. India has been exporting about 6 million tonnes over the past several years. The extra 1 million tonnes compensates only partially for the estimated drop of 3 million tonnes in Brazilian exports.

Brazilian mills have all but finished crushing this year's cane crop. The new-crop harvest and crush season does not begin until April. In the interim, the market will rely on Indian exports, which can be increased because of large carryover stocks. Thailand has recuperated from two consecutive years of drought and will have an additional 3 million tonnes available, but that just brings Thai exports back to the pre-drought years.

If the bull market in energy persists, we believe that the ethanol/sugar ratio will gravitate back to normal levels, which will put downward pressure on sugar output.

Sugar prices have been weak over the past few weeks (Chart 2). That presents a bit of an enigma, since energy prices have been trading at multi-year highs, putting a bit of a damper on the theory that sugar and energy prices are closely linked. Nevertheless, the supply fundamentals are clear. We have a growing world deficit, and Brazilian output for the coming season is a huge variable.

We recommend buying March sugar, currently trading at about 19¢ per pound. Place initial stops at 18.25¢, close only.

[By Sholom Sanik, October 22, 2021]

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Chart 1 – Brazil ethanol (reals per litre)

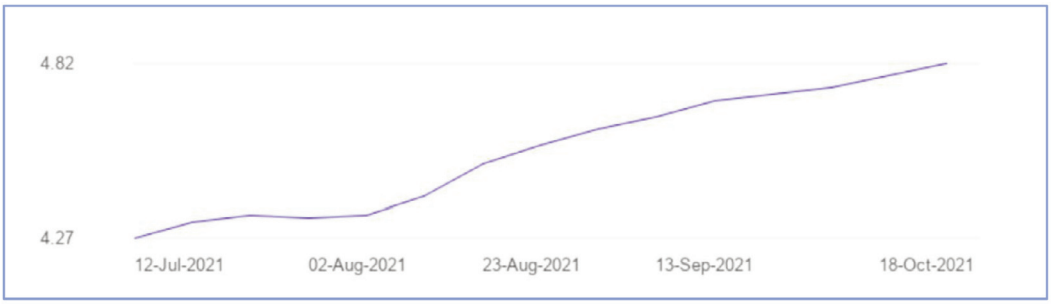


Chart courtesy Globalpetroprices.com

Chart 2 – ICE March sugar



Chart courtesy Reuters

COTTON

Chinese imports: Just the tip of the iceberg

Cotton prices are trading at 10-year highs. Of late, the market has been consolidating the gains (Chart 3). There does not appear to be any single factor so extraordinary as to have allowed cotton prices to maintain these lofty levels. Nevertheless, cotton has outperformed the other large US crops by a wide margin ever since the crops were planted, a diversion that is somewhat of an anomaly when viewed in historical perspective. That includes wheat prices, which benefitted from poor crops both in the US and Canada.

Some recent bullish developments help to explain why the corrections in cotton have been shallow. Although the soon-to-be harvested US 2021-22 crop will be larger than last year's, late-season weather has lowered yields. In its October crop report, the USDA revised national yields downwards, from 895 pounds per acre to 871 pounds per acre.

India is the world's third-largest exporting nation and saw its output estimate lowered by 1.8% in the October crop report.

Chinese production is forecast at 26.75 million bales, down rather sharply from last year's 29.5 million bales.

The Chinese situation, however, is a bit puzzling and, on the surface, does not seem to support a bullish case. According to the USDA, total usage will remain constant at 40 million bales. Yet despite smaller output, imports are estimated to fall by 2.3 million bales, or 18%.

US export commitments to all destinations stand at 8.008 million bales, down from 8.461 million bales last year at this time. Isolating Chinese commitments, sales of 2.363 million bales (shipped and unshipped) are also below last year's level of 3.257 million bales.

It seems, however, that market participants believe that Chinese buying will intensify, and recent activity supports that. In three of the past four weeks, Chinese importers have made large purchases, averaging 288,000 bales. Those are big numbers for this time of year. So, while total commitments are showing that we're running behind last year, as

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illustrated above, the street anticipates that Chinese buying will maintain its momentum, particularly since they are set to harvest a small crop.

The massive global ending stocks – 40% of which are attributed to China – which we've long argued are either overstated or not viable for mills that produce clothing headed for the US and Europe, are still large. However, if we were to ignore whatever portion of those inventories are "bogus," the trend is down.

We are headed into a second season of production/consumption deficits. The global carryover peaked in 2019-20 at 94.9% of usage. The outgoing 2020-21 season is estimated at 75.3%, and for the new marketing year, global ending stocks are forecast to fall to 70.8% of usage. Still, big numbers if they're genuine, but why would the Chinese be buying cotton if they were flush with usable supplies? We believe that the USDA estimates for Chinese imports should be revised upward in the coming months.

We are long December cotton as per our April 9 recommendation. We revised the suggested sell stop to 82¢ on June 25 and now advise raising the stop to $1.02, close only.

[By Sholom Sanik, October 26, 2021]

Chart 3 – ICE December cotton



Chart courtesy Reuters

CORN

Can ethanol save this bull?

Corn prices dropped sharply in response to the October USDA crop report. The report was largely featureless, save for the yield estimate for the 2021-22 US crop, which is currently in harvest. The average of analysts' guesstimates was 176 bushels per acre (bpa), and the actual figure came in at 176.5 bpa. That compares with the September estimate of 176.3 bpa. Prices fell for two days, but subsequently worked their way back into the range (Chart 4).

Ethanol

On October 27 there was an unusual event. The corn market reacted to the Energy Information Administration's (EIA) weekly petroleum status report, which presents a comprehensive update of inventories, output, and imports/exports of US energy products. The report showed that corn-based ethanol production grew by 1.106 million barrels, the second-largest weekly gain in history. The previous weekly record was in 2017. Prices rallied to two-and-a-half-month highs.

Despite strong output, inventories fell to 19.925 million barrels, attesting to solid demand. In fact, inventories have been dropping since mid-summer and are now slightly below where they were at the peak of ethanol consumption in 2017 (Chart 5).

US ethanol consumption peaked in 2017-18 at the corn equivalent of 5.605 billion bushels. Usage then dropped sharply and bottomed in 2019-20 at 4.857 billion bushels. Consumption has since climbed moderately. The estimate for the new marketing year is 5.2 billion bushels.

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Were this to be the beginning of a trend, we believe it could be an important bullish development – a fresh source of demand that could mitigate the uncertainty surrounding Chinese imports.

China

US export commitments for the new marketing year stand at 29.8 million tonnes, 2.5% below last year at this time. At first glance, that actually would appear to be bullish, because the USDA forecasts 2021-22 exports at 63.5 million tonnes, *9% below last year*. There is a problem, however, with being overly optimistic about this statistic. The USDA's forecast for 2021-22 exports is still the highest estimate for any year in which the Chinese were not customers of US corn. And while Chinese purchases (shipped and unshipped) stand at 11.925 million tonnes, they have barely bought a single ear of new-crop corn since a huge purchase of 5.644 tonnes in late May. When we last discussed corn (see *Focus on Futures*, September 13), Chinese purchases stood at 11.909 million tonnes.

The jury is still out on whether the 2020-21 marketing year marked just the beginning of China's status as a regular corn importer or whether it was just an anomaly.

This will be the fifth consecutive marketing year for which China is running a production/consumption deficit. Pitted against Chinese inventory data, which are reportedly equal to about 70% of domestic consumption, we would have to say that the production and consumption data are far closer to reality than the inventory numbers. The evidence lies in last season's imports and this year's early purchases. However, it is disconcerting that the activity has dried up for so many months.

If not for the development on the ethanol front, we would be tempted to throw in the towel on our long position. We came frightfully close to being stopped on our long position, first recommended on April 1. We now suggest raising the stop from $5.00 per bushel, to $5.25, close only.

[By Sholom Sanik, October 29, 2021]

Chart 4 – December corn

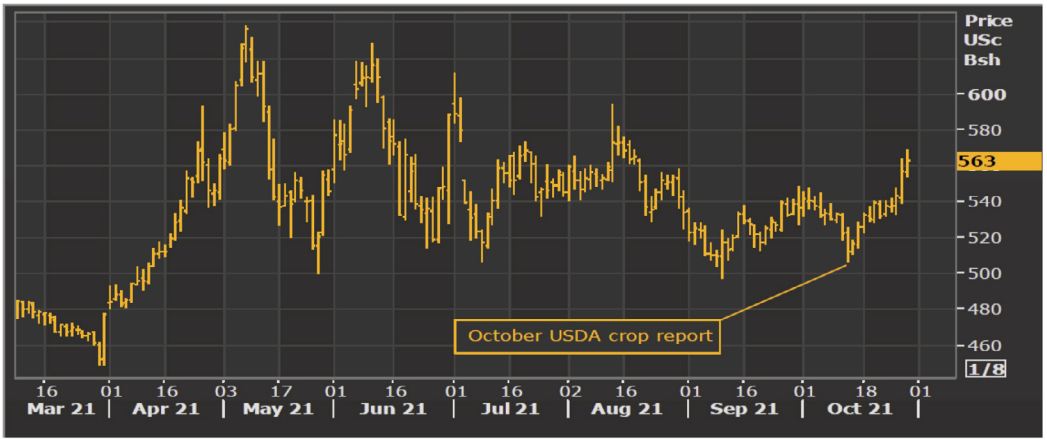


Chart courtesy Reuters

Chart 5 – US ethanol inventories (millions of barrels)

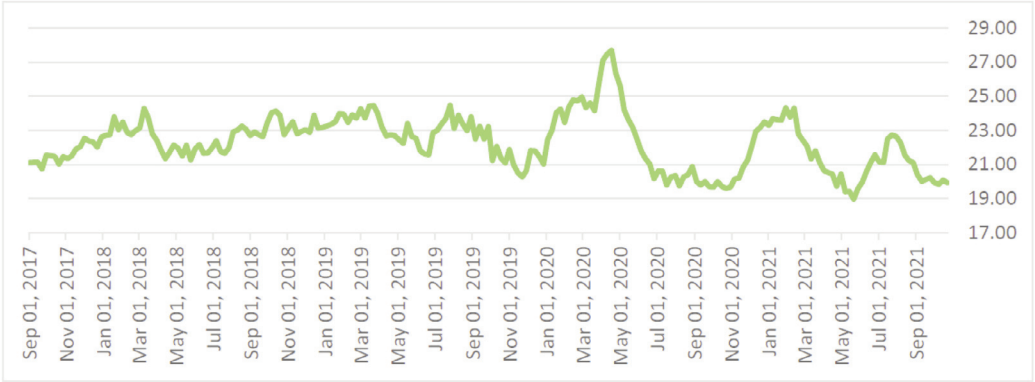


Chart source: EIA

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COCOA

Demand showing signs of life, but it it enough?

The harvest for the 2021-22 West African main-crops has begun. Looking back at the final numbers for 2020-21, three of the four West African producing countries had record crops. Ivory Coast grew 2.189 million tonnes, up 5.5% from the previous season. Ghana blew the lid off the record books with output 1.06 million tonnes, more than 30% higher than a year earlier. Even number-three producer Cameroon saw production grow by 16.4%, to 292,000 tonnes.

The headline numbers for the third-quarter cocoa grind were mostly positive. The EU, the largest non-origin region, was up 8.7%, year-over-year. North America was 4.3% higher. Ivory Coast gained 9.2%. Asia advanced by 4.1%.

Curiously, for a market that suffers from a dearth of regular statistics, the reaction was muted, to say the least. Prices are trading more than $100 per tonne lower since the first report was released on October 12 (Chart 6).

But there is little in the way of enigma here. While the numbers appear to be exciting for bulls, the EU and North America were lower than expectations. Ivory Coast, now the largest grinding region, was actually down slightly for the marketing year that began in September 2020. This is especially disappointing, as Ivorian growth should be strong because of the gradual shift to processing in origin countries instead of Europe.

The supply side has been overwhelming. Ivory Coast and Ghana, which grow close to 80% of the world's cocoa beans, saw combined output for 2020-21 grow by 13.5% from 2019-20. The third-quarter grinding gains for the regions mentioned were roughly 8%. But if we include the first three quarters of the marketing year, the grind only grew by about 3%, even when including the decent performances in the second quarter. This of course means that 2020-21 carryover stocks are piling up.

Indeed, in late August, the International Cocoa Organization raised its estimate for the 2020-21 global production/consumption surplus to 230,000 tonnes, up from a previous estimate of 165,000 tonnes.

Looking ahead, the weather in the early going for West African crops has been favorable for the start of the main crop. Rainfall has been plentiful, but the severity of the dry Harmattan winds that come between late November and March always present a variable for crops. Thus far, Ivory Coast port arrivals stand at 277,000 tonnes, down from 327,000 tonnes last year at this time. It is far too early to draw any conclusions.

We believe that last season's large crops in Ghana and Ivory Coast created a burdensome supply situation. To be certain, farmers are eager to maximize their crops at current prices, which still remain near multi-year highs. We expect arrival data to reflect that as the main crop swings into full gear.

On September 23 we recommended establishing short positions in December cocoa with a buy stop at $2,750. Alas, a brief rally was enough to trigger the stop. We now suggest reentering the short side. March cocoa is presently trading just below $2,600. Place initial stops at $2,850, close only.

[By Sholom Sanik, November 1, 2021]

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Chart 6 – ICE March Cocoa

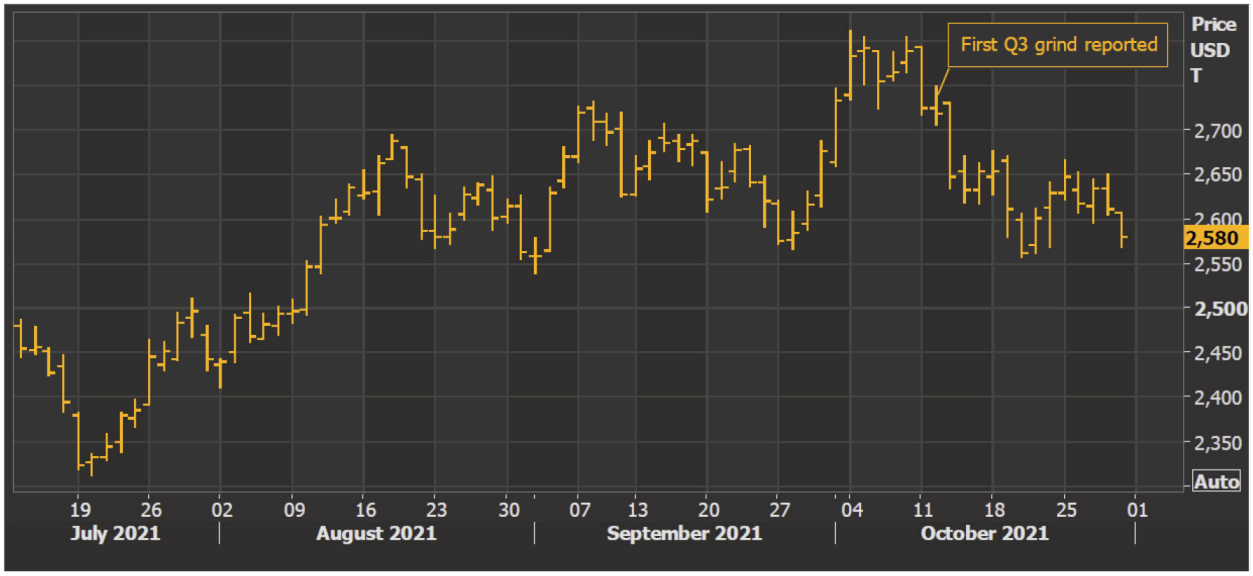


Chart courtesy Reuters

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