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Sugar: the bull rests

The bullish case for sugar has experienced a temporary setback (Chart 1).

Brazil

Ethanol prices in Brazil – which in our view have been the single most significant driver of sugar production – have fallen along with crude oil prices. Chart 2 shows that ethanol prices are down about 20% from the peak set earlier this year. That's almost in lock-step with crude, and indeed, prices have stabilized along with crude over the past two months.

After an unsustainable rush towards ethanol output *vis-à-vis* sugar early in the crush season, the ethanol/sugar ratio has been quoted at 55/45, below the 60/40 ratio that we believe is necessary to keep sugar prices firm.

In the most recent reporting period for the first half of August, there were two interesting notes. First, the cane crush was 14% below the same period last year, an indication that dry weather has affected the crop. Moreover, the ratio shifted slightly back to more ethanol output.

In any case, Brazil continues to struggle in terms of maintaining its status as the world's largest producing nation. Output estimates for 2022-23 are being revised downwards. The government forecast for the cane crop was recently lowered to 514 million tonnes, down from an earlier estimate of 539 million tonnes. That would be the smallest cane crop since 2011-12. Sugar output for the Center-South would be 30.7 million tonnes, down from 32 million tonnes in 2021-22.

Asia

Thai production has recovered from two consecutive seasons of drought, but output of 10.1 million tonnes for the current 2021-22 marketing year is a bit disappointing when compared with earlier estimates. Indian output, however, will be a record 35 million tonnes.

We used to speak of Indian sugarcane-based ethanol as somewhat futuristic. Well, the future may be just around the corner. The government moved forward its target of achieving a 10% blend in all gasoline to this year from an earlier target of 2023. Furthermore, the goal of a 20% blend has been moved forward to 2023 from 2025.

To be sure, the optimistic plans notwithstanding, India is no Brazil. While India is far more populous, gasoline consumption is about 70% of Brazilian usage. In addition, it is unclear whether the processing infrastructure is sufficient to meet the anticipated volumes. About 85% of ethanol plants are in Uttar Pradesh, one of the main sugar-growing regions, and distribution throughout the country will be costly.

Still, we believe that there could definitely be an impact on the sugar market. The diversion of sugarcane to ethanol will be a drop in the bucket when compared with Brazil. However, if the program succeeds, it could mean that sugar production in India has peaked. In a year of a weak monsoon, even a 1- to 2-million-tonne loss of sugar production to ethanol would be enough to make the difference between a global surplus or deficit. India's ethanol program in itself poses no threat to world sugar supplies

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over the next 12 months or so. But moving forward, sugar traders will have to monitor its progress.

For the moment, sugar prices are in a slump. But we believe that the long-term bull market remains intact, mainly because energy prices are still strong enough to sustain an ethanol/sugar ratio above the historic norm. Option prices are inexpensive in terms of historical implied volatility. We therefore recommend the purchase of May 18.50 sugar calls, currently trading at about 0.65.

[By Sholom Sanik, August 26, 2022]

Chart 1 – Weekly ICE sugar – nearest contract

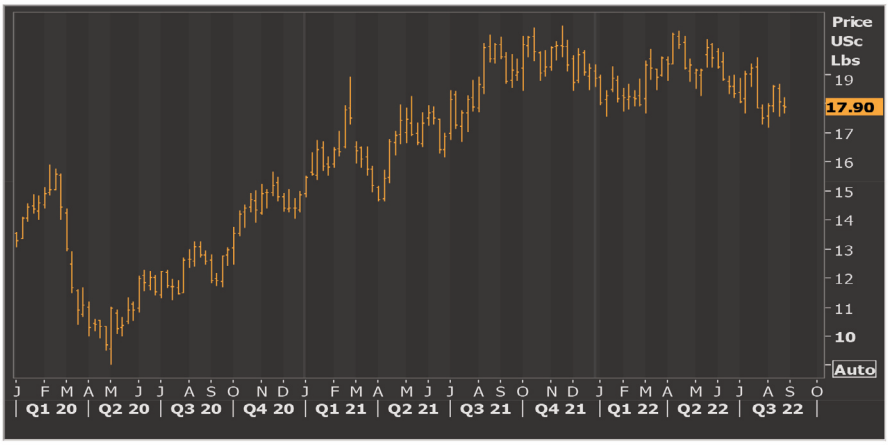


Chart courtesy Reuters

Chart 2 – Brazilian ethanol prices (reals per litre)

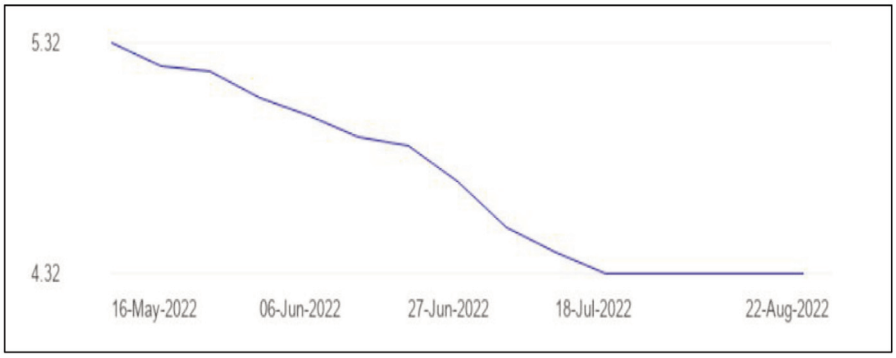


Chart courtesy Globalpetrolprices.com

SOYBEANS

Whatever happened to the bumper crop?

As we approach the harvest of the 2022-23 US crops, the USDA monthly reports have been full of surprises. Weather has been challenging all summer long. Yet in August, while corn and cotton output estimates were slashed, the bushel-per-acre (bpa) yield for soybeans came in higher than expected. Believing that the USDA estimate for soybeans was unrealistically optimistic, the average of analysts' guesstimates leading into the September report was 51.5 bpa, which would be down from the August estimate of 51.9 bpa. The actual figure came in at 50.5 bpa.

In addition, planted area was cut by 500,000 acres. It is noteworthy that when soybean prices rose alongside wheat and corn in the early days of the war in Ukraine, it was assumed that soybean area would expand to take advantage of the price spike. The original USDA planted acreage report in March estimated US area at a record 90.95 million acres. The June estimate shaved that forecast to 88.32 million acres. The new acreage estimate of 87.5 million acres is just a shade above 2021-22 area of 87.2 million acres. This is a bit of an enigma, considering the high prices that farmers were able to lock in.

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US ending stocks were revised down by 40 million bushels, to 200 million bushels (5.44 million tonnes), or 4.5% of consumption. That would be the lowest carryout in nine years. All told, even after trimming the export forecast, the downward revision for the estimate of total output was enough to shake up complacent bears. Traders greeted the September report with a $0.76 per bushel rally, which took the market above the high of the summer's trading range. Prices have since consolidated the gains (Chart 3).

In our previous discussion of sugar (see *Focus on Futures*, July 26), we presented a bearish argument based not only on the presumption of a large US crop, but also on the fact that South American production keeps rising every year. Brazil and Argentina combined are expected to harvest 200 million tonnes in 2022-23. That's up 15% from the previous season. Actually, that increase is a bit misleading because Brazil had an off year in 2021-22. But even when looking back a little further, new-crop Brazilian and Argentinian output will still be 7.5% larger than in 2020-21.

Nothing much has changed in China. The Chinese still grow only about 15% of the domestic crush, and the balance of its needs are met with imports. And while Brazil proved to be a reliable supplier to China during the US tariff period, new-crop supplies are not available for several months. It is impossible to know how the crop will fare. The 2022-23 crop is just entering the planting season now, and the harvest does not begin until January.

The world balance sheet certainly does not evoke anything to panic about, even after the haircut to the US crop. Assuming South American weather is well behaved, ending stocks are estimated at 26.2% of usage, down from the August estimate of 26.8%, but still up from 24.7% last year. Nevertheless, if Chinese imports are strong, the US can be as close to running out of beans as it has been at any time in the past several decades. And that is what traders will be focusing on.

On July 26 we recommended establishing a short position in November soybeans on rallies, and those conditions have been met. Our current buy stop is $15.25. With the market now trading at about $14.70, we now advise covering short positions. Stand aside.

[By Sholom Sanik, September 22, 2022]

Chart 3 – CBOT November soybeans

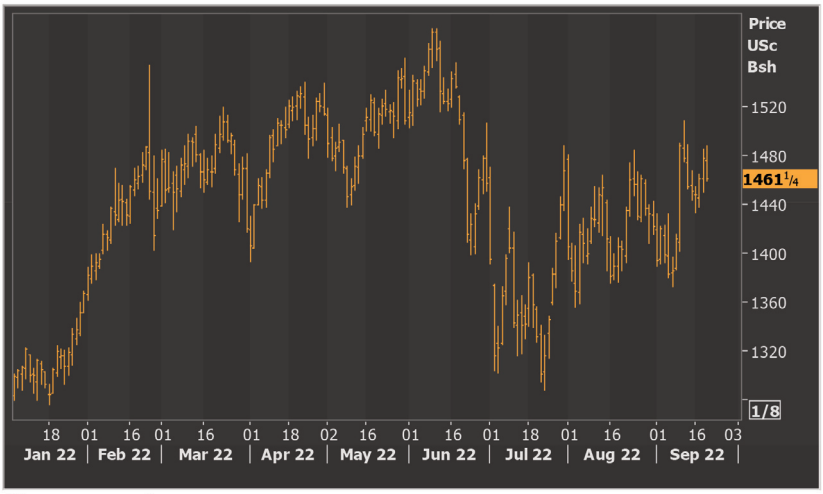


Chart courtesy Reuters

COTTON

US gains vs. Pakistan losses

The August USDA crop report basically rewrote the script for the US cotton picture – or at least it seemed that way for a while. While the street was aware the cotton crop was in trouble, the magnitude of the revisions was staggering. Only 57% of the area that was damaged by inclement weather was expected to be harvestable, down dramatically from historical norm (see *Focus on Futures*, August 19). Cotton prices rallied about 15% in the space of just three trading sessions (Chart 4).

Along came the September crop report and "found" 1.3 million acres, a 10.5% increase. The ratio of harvested-to-planted acres remained the same, and the yield was

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lowered just a tad. The USDA had been working with planted area of about 12.5 million planted acres, based on the March planting intentions report. The extra acres definitely took traders by surprise. No explanation was offered in the notes accompanying the crop report. The rally inspired by the August report had already been erased heading into the September revisions, but the acreage shock brought more selling.

With the revision, US ending stocks for 2022-23 jump to 2.7 million bales, to 18.1% of usage, up from 12.5% last month. This compares with 21.8% in 2021-22 and 16.8% in 2020-21.

One variable that could still tighten the US balance sheet is exports. The USDA has been forecasting sharply lower exports. In 2020-21 the US sold a record 16.35 million bales abroad. In 2021-22 that figure fell to 14.62 million bales. Even after an upward revision in the September crop report of 600,000 bales, to 12.6 million bales, the estimate seems low. While it would be easy to toss an explanation of a slowdown in global activity to account for this estimate, the hard facts show otherwise. Total US export commitments stand at 7.9 million bales, up from 6.7 million bales at this time last year. And it's not just China. Sales to all major importing destinations are above last year's levels, including all European and Asian importing countries.

So as far as the US supply side is concerned, the emergency has abated. The demand side, as illustrated, remains a potential bullish factor.

Another major event has unfolded for the global cotton market. Devastating floods in Pakistan caused by a very strong monsoon season have been catastrophic for millions of people and have wreaked havoc with crops. The estimates of cotton-crop losses are all over the map. Early government estimates show that close to half the crop was lost. The USDA – characteristically – made only a modest revision in the September crop report, lowering production by 700,000 bales, to 5.5 million bales, a reduction of only 11% from the August estimate. The Liverpool Outlook estimate is 3.9 million bales, a 40% drop.

Pakistani mills are a major source of global textile exports. Domestic cotton production accounts for about 60% of mill usage with the balance coming from imports. The Pakistani government has a cap on cotton imports from India. The Pakistan Textile Exporters Association has applied to the government to allow for licenses to raise the import cap. This certainly serves as an indication that the losses in Pakistani output are a serious matter. Pakistan is the second-largest single country importer of US cotton behind China, and you can bet that it will be in the market for more in the coming months. In any case, the losses in Pakistan are at the very least as large as the output gains that resulted from the USDA's revision to the US crop.

We were stopped out of our long position in December cotton initiated on August 19 at 99¢ per pound. Given the situation in Pakistan, we believe that the global balance sheet will eventually reflect a tighter market. We suggest re-establishing a long position in March cotton currently trading at 85¢. Place initial stops at 78¢ per pound, close only.

[By Sholom Sanik, September 28, 2022]

Chart 4 – ICE March cotton

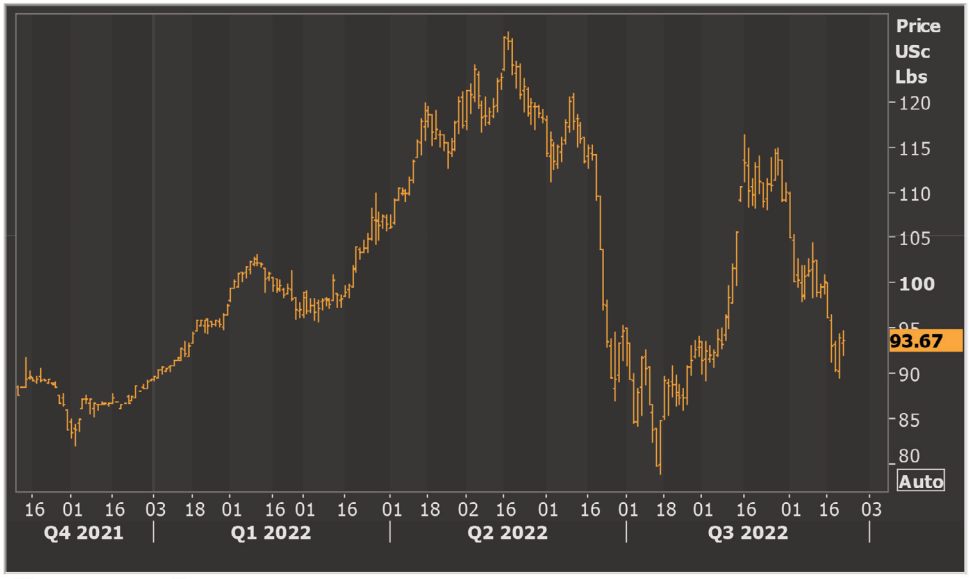


Chart courtesy Reuters

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CORN

Conflicting signals

Commodity prices rallied sharply earlier this year. Much of the strength could be tied directly to the war in Ukraine, particularly for energy and grains. However, even as the war raged on, prices peaked months ago and, for the most part, continue to slide. Corn prices have outperformed other commodities during this period, both related and unrelated (Chart 5).

First, on the supply side, in 2021-22, Ukraine produced 42.13 million tonnes of corn. The USDA estimates that for the current marketing years, output fell by 25%, to 31.5 million tonnes.

Poor weather saw estimates for US 2022-23 output fall all summer long. Early forecasts for a 177 bushel-per-acre yield and a healthy crop of 14.5 billion bushels (367 million tonnes) crop have now dipped to 172 bpa and output of 13.9 billion bushels (353 million tonnes).

Key exporters Brazil and Argentina are planting large crops. Expectations are for output to increase by 8.5% and 7.5%, respectively. It is quite early, and those crops are not available for several months, so weather is still a variable.

Even if South American crops meet their forecasts, the USDA estimate for global production is 1.173 billion tonnes, down 3.7% from 2021-22.

The other side of the coin, demand, at least on the surface, neutralizes the bullish supply side. The USDA estimate for global demand is estimated to fall by 1.9%. US exports – arguably the single most significant indicator of the health of global demand – certainly supports the USDA forecast. The October crop report slashed the estimate by 3.18 million tonnes, to 54.61 million, down 5.5% from the September estimate. That would be 13% lower than 2021-22 exports. While it's still early in the 2022-23 marketing year, export commitments stand at a rather pathetic 13.8 million tonnes, 48% of last year at this time.

And it's all about China. At this point it would be quite reasonable to assume that extraordinary Chinese imports we saw over the past two seasons were, indeed, a flash in the pan. In 2020-21, imports from all origins jumped from next to nothing historically to 30 million tonnes, or about 16% of world trade. So far this season, Chinese imports (which are mostly unshipped and could be cancelled) stand at 3.4 million tonnes, down from 11.9 million tonnes at this time last year.

Corn-based ethanol usage in the US makes up about 37% of total corn consumption, so it is a factor to be reckoned with. Inventories have been slipping all year long (Chart 6). In its October crop report, the USDA lowered its estimate for US ethanol consumption by the corn equivalent of 50 million bushels (1.28 million tonnes). Ethanol usage is based on the government mandate to blend at least 10% with gasoline. The total amount of ethanol consumed is therefore a function of overall gasoline consumption, which has softened. Chart 7 shows that while we have recovered from the pandemic nosedive in consumption, we have not returned to pre-pandemic levels.

In the pre-pandemic years, US ending stocks were averaging about 14%. The introduction of China as a buyer of US corn over the past two seasons was responsible for pulling that figure down to the 8% level. The sharp drop in US output this summer has kept the forecast for 2022-23 at 8.3%.

As noted, we're looking at a tug of war between the supply and demand sides. If South America muddles through, we can see corn prices faltering. If demand improves in both export and domestic ethanol usage, US inventories are in a position to move down to historically low levels. We're going to let the charts decide. If March corn breaks above $7.05 per bushel (currently trading at $6.85), establish long positions. If filled, place initial stops at $6.50, close only.

[By Sholom Sanik, October 28, 2022]

Chart 5 – Corn vs soybeans (top) Corn vs. Bloomberg Commodity Index (bottom)



Chart courtesy Reuters

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Chart 6 – US ethanol inventories

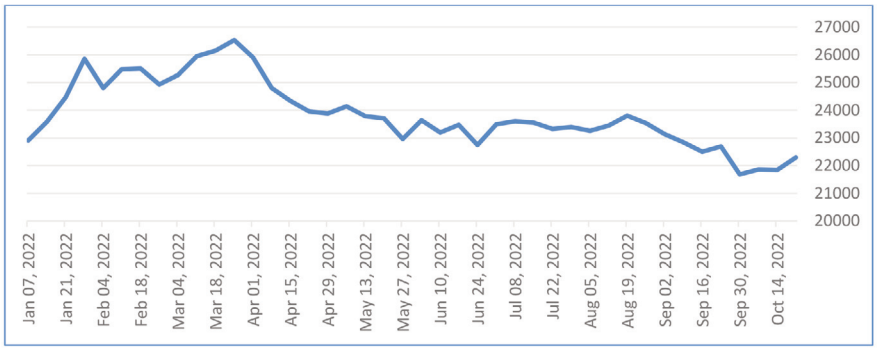


Chart source EIA

Chart 7 – US gasoline consumption

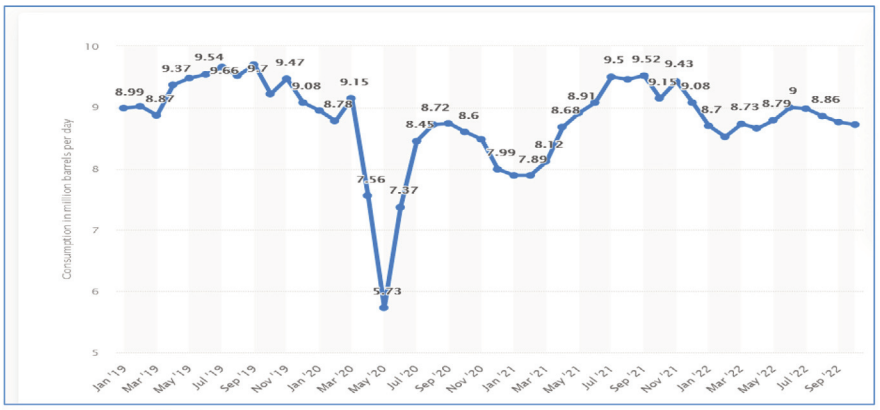


Chart courtesy Statista

Chart 8 – March corn

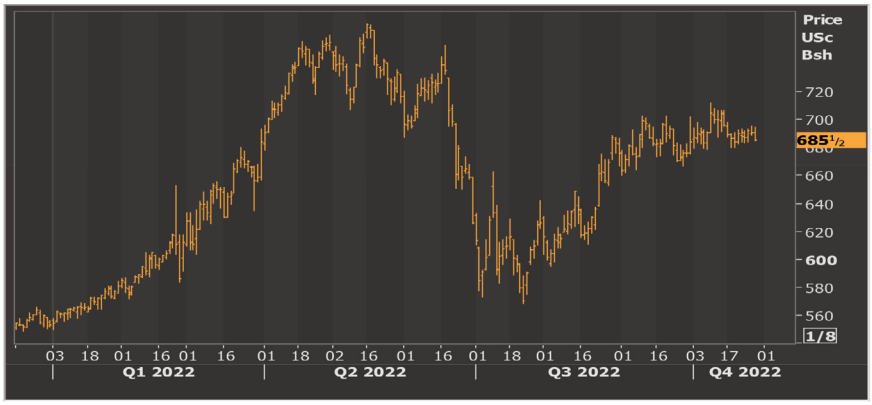


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