Research

Monthly Sugar Note

30 November 2022

Markets

The macro environment finally appears to be turning. The dollar has started to weaken, admittedly slightly earlier than expected, on expectations the Federal Reserve may afford to be less aggressive with its interest rate hikes. The switch to a more Risk-on mode was the US CPI data, which increased less than expected in October, suggesting underlying inflation in the USA is cooling. The subsequent sell-off in the US dollar gave some relief to financial markets such as equities and currencies.

Commodities, however, were unable to improve much over the past month as the seemingly never ending COVID zero policy in China – still the largest single importer of commodities - continued to weigh on demand. Rumours (since denied) that OPEC may increase oil production in December took Brent crude to below $75/bbl by late November. However, losses have been reduced in the past days amidst speculation that China will eventually have to end its draconian COVID measures following growing unrest by a population increasingly tired of lockdowns.

Still, the positive macro sentiment gave an additional push for speculators to return to the sugar market. The latest Commitment of Traders report showed the net long position (as of November 22) at 169k lots, the highest since May. Sugar prices reached almost 20.5c/lb on November 16th, the highest level of the past 7 months. More recently, NY11 futures have corrected somewhat, returning to the mid 19c/lb levels.

Figure 1: Commitment of Traders

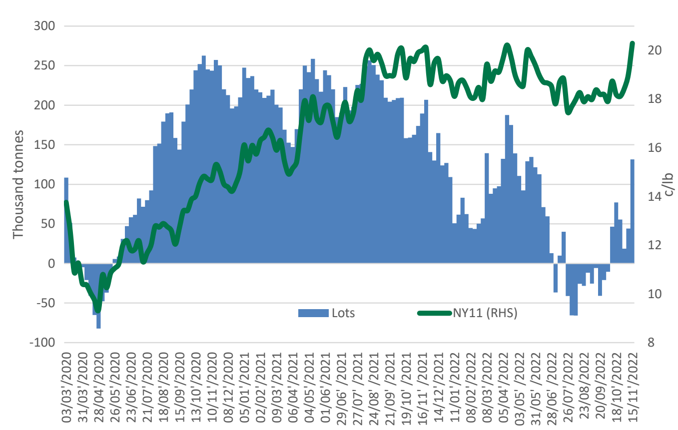
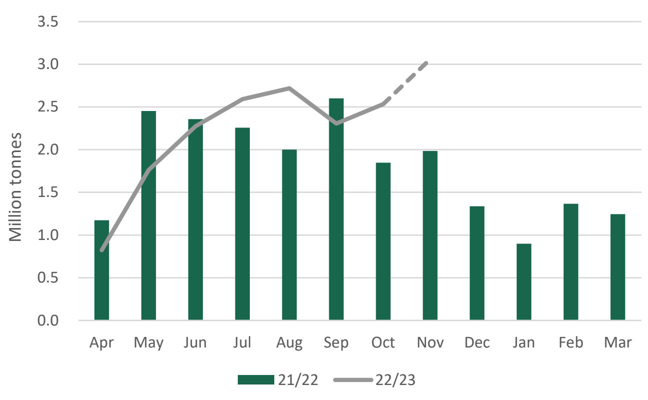


Figure 2: C/S bulk raw monthly exports



Source: Reuters and ED&F Man Commodity Research

The end of the C/S Brazil crop is showing good progress. According to UNICA, up to the first half of November sugar production was close to 32.0mmt, 0.3% ahead the past season. Unlike the previous crop, which was virtually over by November, we should see mills harvesting up until December, taking the 22/23 crop volume so far close to 33mmt, about 1mmt higher than the 21/22 crop.

While C/S supply may not necessarily be a bullish factor, the demand side tells a different story. October bulk raw exports ended at 2.5mmt (vs. 1.8mmt in Oct/21) and November exports (including nominations) are already over 3mmt (vs. 2.0mmt in Nov/21). Brazil continues to be the only supplier of sugar today, as Northern Hemisphere crops have only just begun.

In India, up to November 15th, sugar production is trailing last season's, at 1.9mmt (vs. 2.08mmt a year ago). Some 321 factories were operational (vs. 308 mills in 2021). Production is ahead of last year in Uttar Pradesh but lags in both Maharashtra and Karnataka, where the delayed withdrawal of this year's monsoon resulted in some mills starting later.

Like Brazil, the demand side is also constructive for India. After the announcement of India's 6mmt export quota early in November, local press has been suggesting that about 4mmt have already been commercialized. Some mills that have sold sugar in Sep/Oct reportedly cancelled contracts to take advantage of the recent price increase. The market took the news as supportive, helping push NY11 values higher over the past few weeks.

Medium-term we struggle to see the market as over-supplied, considering India will decrease its exports from 11mmt to anything close to 7mmt this season. Thailand's larger crop will help reduce the gap; but will not be able to offset India's losses. In view of this, the market will focus on Brazil. For the time being ethanol does not look like much of a threat, regardless of any potential return of taxes in the Brazilian fuel system under the new Lula government. Nevertheless, C/S sugar output will only gain traction after Jun/Jul. All in all, we expect the 22/23 surplus to only become "apparent" in the second half of 2023. Until then, NY11 will have to rely on Indian production, but export quotas can be a problematic feature, and the market will have to deal with it.

The December refined sugar contract expired mid-December with 360kt delivered, 27% above the previous year and 44% higher than the historical average. Similar to last year, India was the main supplier, representing 100% of the sugar delivered.

Fundamentals

- **Brazil C/S:** UNICA data showed sugarcane crushing and sugar production in the C/S region more than doubling in the first half of November on a yearly basis, as mills rushed to catch up with last season's levels. Crushing totalled 26.3mmt in the period, about 110% higher YoY, while sugar production jumped 162% to 1.7mmt. Cumulative sugar production since the start of the season was at 32mmt. According to UNICA, 140 mills were still harvesting during the period (vs. 65 mills last season). Assuming we get benign weather for harvesting, and with the higher numbers of mills still operating, we should see another good production number in the Second Half of November, which will take sugar output close to 33mmt. As weather between now and the end of Q1 is the most critical period for cane development, there is a lot of scope for cane availability for 2023/24 to change significantly.

- **India:** The government of India announced on 5th November that it would allow the export of 6mmt of sugar for the current 2022-23 season. As per market reports, 4mmt contracts of sugar export contracts have already been entered into so far. Indian mills have been renegotiating and defaulting on contracts to supply around 1mmt of sugar, which has been supporting global prices. India produced 1.99mmt of sugar till 15th Nov 2022 vs 2.09mmt last year - 4.6% lower. This season, 383 sugar mills have started their crushing operation, out of a total of 530 mills expected. Latest feedback from sugar millers from Maharashtra and Karnataka, indicate agri yields of harvested cane fields are coming in lower than expected.

- **Asia:** Thailand's rainfall continues to perform well, with the cumulative rains now almost at the record 2017 levels. As we approach the start of the harvest in December, weather needs to dry up in order to ensure a smooth start to harvesting operations and provide critical sugar for Q1'23. Quota B has also been recently concluded for Jul/Sep sugar for 36k with bids around the 150-170pts area. This shows a relatively tight consensus of the price range where that sugar should be valued at this point in time. Views for the crop remain at around 100-110mmt cane, but there may be some complacency in this range given the strong rainfall. Areas of demand to watch include licenses for Indonesia next year (given strong consumption recovery trends there) as well as the situation in Philippines, which still looks tight.

- **US:** The November WASDE had important updates for the US market. A small increase of 37k MTRV for the 21/22 crop (given higher production), combined with lower domestic demand, increased the beginning stocks for the 22/23 crop. The new season saw some important changes too: production was reduced by 63k MTRV, but consumption was also trimmed. As expected, TR2 imports were revised up and we expect this to continue over the next few months. But the major change was the reduction in the Mexican quota - which implies the 13.5% STU ratio is not achieved – and reflects a lack of Mexican availability from USDA's point of view. The USDA assumes Mexico's crop at 5.9mmt, meaning only 1.22kt mt would be available for the US. If USDA's Mexican crop projection ends up being correct, it could be a good year for TR2 and TRQ countries. Good domestic supply is seen for the US this season as the beet crop is mostly fully harvested, although weather in the coming months will be important to preserve the quality of the beets. The sugar cane crops meanwhile are currently projected at their second highest level in history.

- **Mexico:** Mexico's new crop has started and production figures over the next few weeks will be important for a better reading of field conditions and cane availability. We have reduced our estimate from 6.1mmt to 6.02mmt given the adverse conditions registered mostly in the northeastern region of the country. Conadesuca has released a similar estimate of 6.03mmt, but it is projecting higher acreage with lower yields. For that reason, all information from the fields will be analysed to determine eventual sugar availability. In any case, we expect export availability of only 1.48mmt, out of which 1.25mmt should go to the US, leaving a relatively small volume for WM exports during the season.

- **Centrals:** The new crop has started in the region with many mills already running. The combined regional expectation is for a small decline in production of around 1%, mostly due to a small reduction in Guatemala. Although it is still the beginning of the crop, sugar exports have already started to gather pace, especially for bulk raws and refined sugar. This likely reflects the absence of Guatemalan refined sugar being delivered at the December expiry, which is unusual whenever the market structure is inverse.

- **EU/UK:** The weather over the past 6 weeks has shown temperatures above average by between 5-10 degrees in much of Europe. This had led us to increase our sugar production estimate. However, more recently, German sugar association WVZ released an estimate with production closer to 3.9mmt, a drop of 190k from their previous estimate. This led us to reverse our increase, as it seems the weather has not yet had the positive impact expected, possibly because of the extended drought over the summer. We currently have EU+UK production at 16.0-16.1mmt (using Commission methodology which includes alcohol). Imports are expected to come in at the strongest level seen in many years, totalling 2.8-2.9mmt, as CXL raws come in large quantities for the first time since the quota period. Exports are expected to be a minimum level of 600kmt. This takes our balance sheet to close to balanced, meaning any stock increase or decrease will likely be determined by the level of consumption.

Focus – CIS

The eyes of the entire world have been watching this region now for more than 9 months. Despite this, the final outcome of Putin's conflict is still shrouded in mystery. The futures market for those commodities that rely on exports out of the region, such as oil/grains/soybeans/natural gas have all had extreme price turbulence as a result. Sugar, on the other hand, which historically doesn't impact the world market price in the same way, has been relatively under the radar.

Planting area in Russia increased by 3% in the spring, after last year's disappointing crop of 5.6mmt led to a decrease in stocks for a second consecutive year. However, this summer's weather proved beneficial for the beet crop, with yields expected to reach the highest level since the record crop of 2019/20. As we approach the end of November, harvesting is near completion at 94% of total sown area; but the pace has slightly slowed in recent weeks. Of the main growing regions, the Central Federal district is lagging the others, having completed 92%. The danger is that the fast-approaching cold snap freezes the ground before the last of the beets can be harvested. This, combined with potential losses at pre-processing storage, should lead to a production figure between 6.2-6.3mmt. With consumption at 5.9-6.0mmt, this will allow availability for export into the CIS region.

Figure 3: Russia and Ukraine sugar production

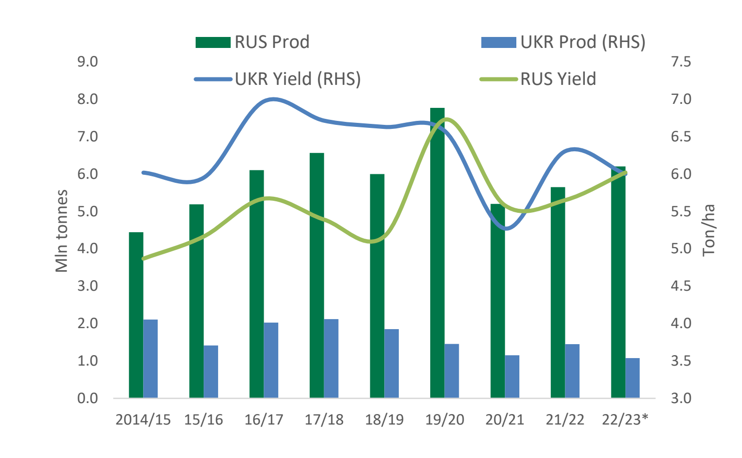
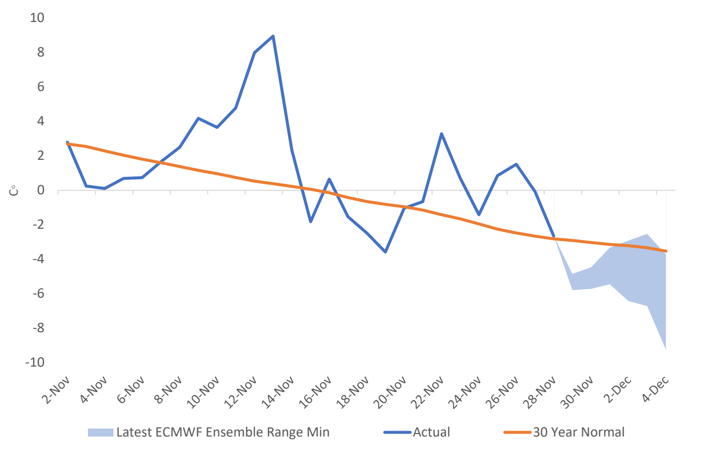


Figure 4: Voronezh daily mean temp. and forecast



Source: Reuters, ANP and ED&F Man Commodity Research

Ukraine has been the surprise of the region, showing incredible resilience to produce a healthy upcoming crop for the 22/23 season; we expect a production figure of 1.05-1.10mmt. With a portion of the population migrating, consumption has dropped to 0.9-1.0mmt, meaning this year will see a surplus of between 100-200k tonnes. This, combined with a build-up of stocks the previous year, allows for a large export availability. However, with regional exports to the east blocked off, and any potential commodity flows via the Black Sea prioritised for grains, Ukraine has only one option: Europe. The duty free quota of 20kmt that Ukraine has annually was amended following the invasion to remove any quantity restrictions. This is set to last until June 2023 and may be extended further. Hence, with high domestic prices in Europe, we have seen 65kmt enter EU from June to October, a flow that is likely to continue in the coming months. How much they manage to move, however, will depend entirely on logistics. But so far, trucks have been flowing in abundance.

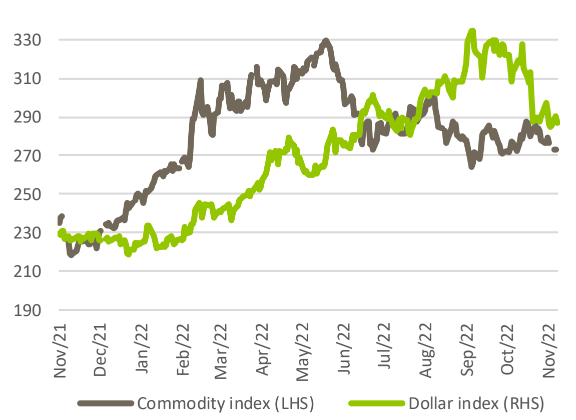
In the deficit countries of the 'stans', raw sugar is likely to be the main source of supply once more, given our Russian export assumption of 300-400kmt. However, refineries may need to compete with surplus Indian sugars, and even potentially - for the first time in years - some Pakistani sugar.

Macro

The Institute of International Finance (IIF) warned the world economy will be as weak in 2023 as it was in 2009, as the war in Ukraine may become a "forever war". Their global GDP growth forecast is just 1.2%, with the Eurozone -2%, the US up 1%, Latin America 1.2%, and the hope being China will loosen Covid curbs – which seems a big ask right now. The OECD was less negative by comparison, forecasting global growth in 2023 at 2.2% (from a previous forecast of 3%), just about avoiding an all-out recession. Russia and UK stood out as the weakest performers over the 2-year horizon, with Germany and Europe just about recovering in 2024.

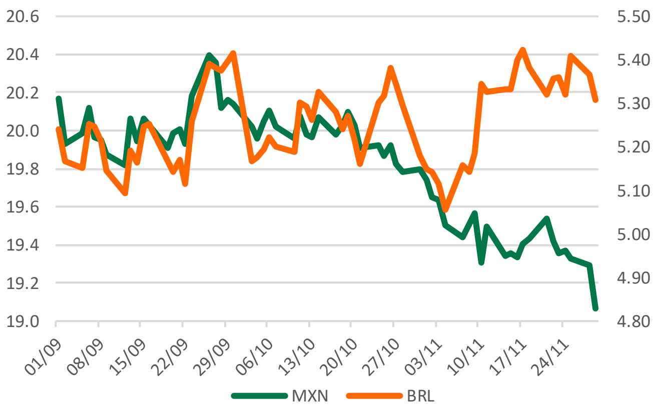
Minutes from last month's Fed meeting indicated several officials backed the need to moderate the pace of rate hikes, even as some underscored the case for a higher terminal rate. This adds weight to expectations the Fed will raise rates by 50 bps next month, ending a run of jumbo 75 bps increases. While this is not a "pivot" as such, we are seeing the beginnings of a slowdown in rate hikes (rather than the start of outright cuts, which according to the latest futures pricing will not take place until July next year). We may well look back and say this was the peak of it. The dollar is now down 8% from its peak in late Sept; the apparent change in the USD's fortunes is occurring a little earlier than anticipated. The three key forces that propelled it to multi-decade highs (namely; hawkish Fed, slower economic growth, and risk aversion) may be losing steam. USD rates remain elevated compared to other currencies, but Fed rate expectations may already have peaked, especially if US inflation shows further signs of subsiding. That leaves economic growth and risk aversion as the two remaining pillars of support for the dollar.

Figure 7: Dollar seems to have peaked



Source: Reuters, ED&F Man Commodity Research

Figure 8: Yet the BRL struggles to strengthen



Source: Bloomberg, ED&F Man Commodity Research

Despite the weaker dollar, the Brazilian currency has struggled to strengthen, reaching lows of 5.40 this week. After weeks of silence following Lula's victory, Bolsonaro's Liberal Party decided to challenge the outcome of last month's election. While it's unlikely that much will come out of this, it lends voice to those who have been protesting the outcome and has already led to truck freight disruption. Meanwhile, while the market continues to penalise a lack of fiscal credibility with a higher risk premium, it may be premature to jump to conclusions before seeing President-elect Lula's actual policy details and cabinet appointments. His tight margin of victory over Bolsonaro and the congress' shift towards the right suggest he will be pressured to move to the centre to govern effectively. If he listens to the market's strong message of disapproval of the past two weeks, he may opt for a more moderate fiscal stance.

Crude oil prices have also been struggling over the past month. Three key factors have kept prices low: 1) China, the world's top oil importer, continues to enforce mobility measures and other curbs to control record COVID outbreaks, which is starting to hit fuel demand. 2) The G7 and EU, who for a while now have been discussing a Russian oil price cap to limit revenue to fund Moscow's military offensive in Ukraine without disrupting global oil markets, are reportedly thinking of a cap $65-70/bbl. As this is broadly in line with what Asian buyers are already paying and is significantly higher than Russia's costs of production (of around $20/bbl), this should not reduce oil supplies. 3) Finally, trading is cautious ahead of the EU ban on Russian crude on 5 Dec, and ahead of the next OPEC+ meeting on 4 Dec.

Upcoming Areas of Interest

- **Brazil C/S –** Final production results of C/S Brazil's crop; weather outlook during intercrop period
- **India –** Export pace, especially after the recent defaults. Will more quota announcements happen?
- **Thailand –** Crop progress after the delayed start
- **Centrals –** Crop advancement and export paces
- **Macro –** Will speculators maintain their long positions given the China Covid surge, or increase as the dollar weakens?

Prices Tab

New York #11					**London #5**				
(cents/lb)	28-Nov	30-Sep	% change		*($/tonne)*	28-Nov	30-Sep	% change	
Mar (23)	19.38	17.68	9.6%	↑	Mar(23)	528.6	492.0	7.4%	↑
May (23)	18.35	16.94	8.3%	↑	May (23)	520.7	481.0	8.3%	↑
New York #16					**White Premium**				
(cents/lb)	28-Nov	30-Sep	% change		*($/tonne)*	28-Nov	30-Sep	% change	
Jan (23)	36.00	34.94	3.0%	↑	Mar/Mar	101.3	102.2	-0.9%	↓
Mar (23)	36.10	34.94	3.3%	↑	May/Mar	93.4	91.2	2.4%	↑
Macro					**Currencies**				
Indicators	28-Nov	30-Sep	% change		*Against US$*	28-Nov	30-Sep	% change	
CRB	272.9	268.3	1.7%	↑	Euro (EU) *	1.034	0.980	5.5%	↑
Gold	1,741	1,660	4.9%	↑	Pound (GB) *	1.196	1.116	7.2%	↑
Brent Oil	83.19	87.96	-5%	↓	Real (Brazil)	5.365	5.415	0.9%	↑
Baltic Dry	1,347	1,760	-23%	↓	Rupee (India)	81.64	81.51	-0.2%	↓
Handysize	746	1009	-26%	↓	Rouble (Russia)	60.85	59.20	-2.8%	↓

(* rate is US dollars per FX)