ED&F MAN EST. 1783 | Research

Monthly Sugar Note

27 October 2022

Markets

The 21/22 Oct/Sep season ended with a small deficit, the third consecutive year of a tight balance in the World Sugar market. For the 22/23 season, the market sees the first significant surplus since 18/19. The surplus is made up of India having another big crop (albeit smaller than the past season), Thailand seeing a crop increase of about 2mmt YoY, and favourable rains in Brazil. Yet despite the higher supply, we may not see prices dropping short-term.

In the immediate term, market prices will continue to be a function of the Indian export quota and weather in the main producers. Markets have been eagerly waiting for India to announce their export quota for the past 4 weeks, but nothing has been materialized yet. The longer India takes to announce this, the more NY11 will persist in staying close to the Indian FOB price level in order to entice supplies - today this level is near 18.3c/lb. The market will, in the interim period, become even more dependent on sugar from Brazil, where stock levels are tightening given strong demand. Meanwhile, white sugar prices today are still tempting for Indian producers, which can increase the volume of refined (or LQWs) by decreasing raw sales, the later the Indian export policy is announced.

Figure 1: World Market sugar balance

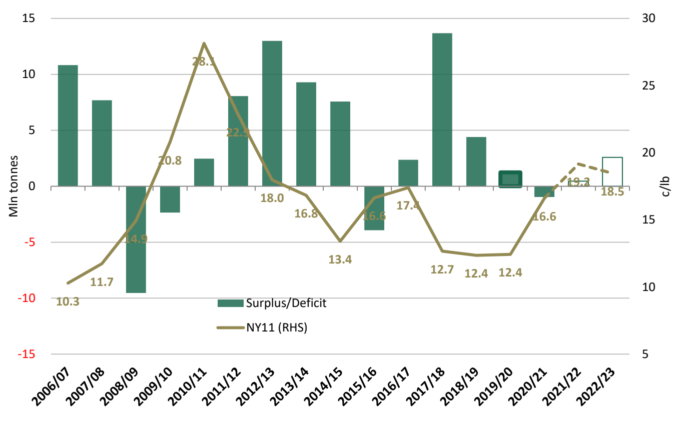
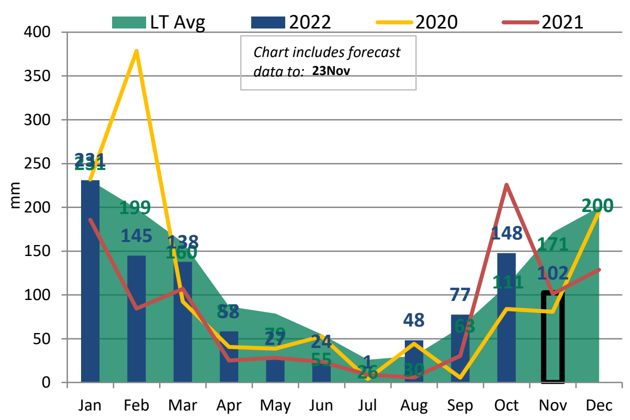


Figure 2: C/S monthly rainfall



Source: Somar and ED&F Man Commodity Research

The weather has also been an important factor in the past weeks. September ended very wet in Brazil, resulting in low cane crush volumes and a decreased sugar mix. The crop that started later than the past season is now being delayed. Up to the end of September, the cane crush is about 35mmt behind the 21/22 crop, while sugar production is 10% lower at 26.3mmt. As a result, we expect C/S Brazil will see a long tail to the season, with mills crushing cane in December too. Rainfall is also above historical averages in some regions of Thailand and India, postponing the start of the crops there. All in all, the transition of supply from C/S Brazil to Northern Hemisphere crops is not looking so smooth, and volatility should be expected in the next months.

Assuming an Indian crop close to 35mmt and Thailand at 12mmt, we still see tight conditions for the market in the first quarter of 2023. Although Thailand may increase exports by 1.5mmt y/y, India will cut its exports significantly, moving from 11mmt in 21/22 to anything close to 7mmt. Consequently, sugar from the Centrals will be needed in Q1/23. Indeed, some businesses with Asia has already been realized, indicating that Centrals may not carry much sugar to the second half of 2023, as was the case in 2022.

In the meantime, the rainy weather in the C/S of Brazil is increasing the forecast for the next C/S crop, pushing some analysts to project a cane output of 600mmt, about 50mmt higher y/y. Considering that Bolsonaro and Lula both provide bearish elements for the ethanol market (see Focus section below), we expect the sugar mix to remain high. Consequently, C/S Brazil's sugar production can easily surpass 35mmt. However, from a global SnD perspective, the 22/23 projected global surplus may show its face only during the peak of the C/S crop, after July 2023.

For the whites market, three factors should dictate prices: the Indian crop size and producers' appetite to export white sugar; the performance of the EU crop, along with energy prices; and finally, the end of the sugar export ban in Algeria. As we get close to the start of the North Hemisphere crops, the White Premium has been falling in anticipation of Indian supplies, but levels remain historically high.

Fundamentals aside, one cannot discount the challenging macro environment we still find ourselves in, and which arguably are likely to get worse. The US Fed is likely to maintain its hawkish stance until the first half of 2023, supporting the dollar. The strong dollar is not just bearish for commodities in general, but lack of access to dollars and weakening EM currencies may lead to some demand destruction in the poorer sugar deficit countries. Overall, fundamentals remain, on balance, bullish today; but given that we are at the edge of a world economic crisis, the sugar market will be pushed and pulled between macro and fundamentals. Expect volatile prices, requiring prudent trading.

Fundamentals

- **Brazil C/S**: Crop results for September and the first half October were strongly impacted by rains, preventing the current season from catching up with last season. As a result, the 22/23 crop will have a long tail, completely different to the results observed in 2022. Producers will have to choose between crushing cane in December or start the following season earlier with more bis-cane. Up to mid-October, C/S crushed 459mmt of cane, almost 6% lower y/y. Sugar production was about 2mmt below the previous crop during the same period, reaching 28.1mmt. As sugar is still paying about 300 points more than ethanol, millers have been focusing on sugar production, with sugar mix results close to 48% during Sep and early Oct. The late start of the crop and the wet weather over the past months are resulting in low stocks in Brazil as the countries continues to be the main source of sugar at a time when both India and Thailand have yet to start their export season. Cash values are at record levels while line up shows nominations close to 4mmt for the next weeks.

- **India:** ISMA released their first advance estimate for India's sugar production at 36.5mmt. This seems on the high side and may be purposely designed to force the govt to allow the maximum quantity of exports. Heavy rains in the north of India and moderate rains in central & southern regions have delayed the start of crushing operations by 8-10 days. The above-normal rains created water logging in some areas of Pradesh that could negatively impact production following the initial lower rains in July, August, Sep. Across India around 30 mills have started the crushing, mainly in Karnataka and Tamil Nadu. The full pace of crushing will start after Diwali i.e., last week of Oct/1st week of November.

- **Asia:** Thailand's rainfall continues to perform well with the cumulative rains now almost at the record 2017 crop 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. Values for Q1 sugar have also been firming up due to the tight situation given the lack of clarity around Indian export quotas. 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:** October WASDE came out with several small changes for 21/22 and 22/23, increasing ending stocks for both seasons. Overall, the USDA increased 21/22 production given higher cane crush in September which more than offset a reduction on the beet side. On the imports side, the seventh consecutive increase on TR2 wasn't enough to offset a reduction on TRQ (rolled into the next season) and overall, imports were lowered by 26k MTRV. Ending stocks for the 21/22 season were increased by 0.2pts to 14.0% S/U ratio. This increase, combined with a small increase in production, but big increase in TRQ, has also increased the S/U ratio of the new crop by 1.3pts to 14.8%. This is a surplus of around 150k MTRV, which could potentially be removed from the Mexican quota in the next reports. The increase in TRQ was a combination of the addition of Specialty quota TRQ to make up for the shortfall of the Philippines TRQ. These were two important flags we had in our scenarios, which are now effective.

- **Mexico:** Mexican producers are a few weeks away from the start of the new crop and are keeping a close eye on weather developments for the next season and the changes in the US SnD. The weather is overall good for cane development, with the exception of the Northeast region where rains were below average. The market is working with a crop number close to 6mmt, but this volume could be reduced by 50-100kt depending on the final rains to be seen in October. The latest US WASDE report did not have good news for Mexico as it increased the ending stocks of country, indicating potentially lower exports, currently estimated at 1385kt.

- **Centrals:** With a few weeks to the start of the new crop, the region is completely dry in terms of sugar availability. The weather has been very wet for most cane growing regions, which on the one hand is positive due to good levels of soil moisture, but on the other hand, reduces the availability of sunlight for the cane, which is important for cane development.

- **EU/UK:** The commission released their 22/23 production and balance sheet estimates at the end of September. They estimated a drop in production y/y of 1.15mmt to 15.5mmt production, while seeing consumption 270kmt lower at 16.56mmt. With a net import number estimated at 760kmt, the commission therefore expect a stock drawdown of 300kmt. This balance sheet was released just before London sugar week, leading to much discussion on the subject. In general, European stakeholders expressed views of a lower crop number than the commission. At the same time, imports were expected to be higher, leading to a smaller

S/U than the commission, and some even seeing a stock build. It is important to watch how the weather progresses for the next month, with current high temperatures and intermittent rainfall showers potentially beneficial for the rest of the crop.

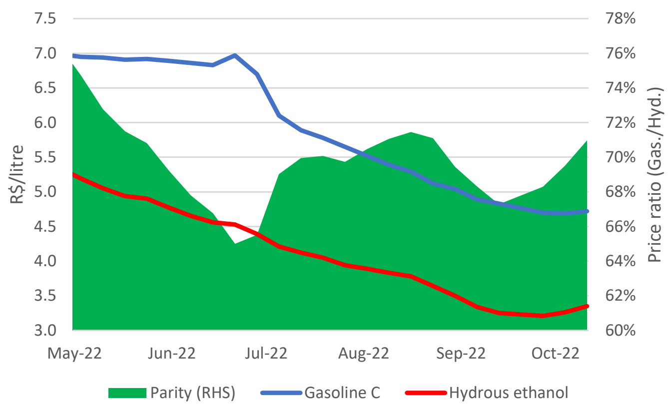
Focus – Lula vs. Bolsonaro

The final round of the Brazilian presidential election between Lula and Bolsonaro will take place on October 30th. Whatever the outcome, Brazil's ethanol producers do not have reason to believe that the ethanol market will be bullish in 2023, and this may change millers' decisions for the next crop.

During Lula's term in office between 2002 to 2012, biofuels were becoming a growing trend globally. New ethanol blend mandates were set in the US, while in Brazil, Flex Fuel cars were introduced. Lula took advantage of this trend and promoted internationally the Brazilian sugar and ethanol industry, in the hope that Brazil would lead the international market in biofuels. In the end, only a few countries adopted blend mandates while the US succeeded in developing its own industry, albeit without the need of the Brazilian supplies. Nonetheless, the ethanol industry increased considerably between 2006 and 2010, with giant trade houses investing in Brazilian cane production.

Figure 3: Petrobras shares

Figure 4: Gas. C vs. ethanol pump prices (SP)



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

Things took a turn for the worse when Lula's candidate (Dilma) took office in 2012. In a push to boost demand (in the hope that it would encourage economic growth), Dilma decided to subsidize gasoline and diesel prices by protecting the domestic market from international oil market moves. Although the Flex Fuel car fleet increased substantially during her presidency, representing more than 80% of the country's cars, the Dilma administration decreased the competitiveness of hydrous ethanol which ended in the bankruptcy of dozens of mills. Petrobras's losses were enormous during that time, with its share price plummeting 80%, from $12 in January 2012 to just $2 at the beginning of 2016. Following Dilma's impeachment, her vice president (Michel Temer) took over in September 2016. Temer returned to an international oil price and exchange rates flow mechanism to dictate domestic prices and restructured Petrobras, returning the company back to profitability after a few years of losses.

Temer's mechanism worked well during the late 2010s, when world oil prices were low and stable – something that Bolsonaro managed to inherit at the beginning of his presidency. However, things changed when crude oil prices exploded higher this year, on the back of the post COVID world economy and Russian invasion of Ukraine. The rise in imported energy inflation was bad for Bolsonaro's re-election plan and the government intervened in the fuel price mechanism by erasing the Federal taxes (Pis/Cofins) and adding a ceiling on States taxes (ICMS). The new mechanism worked well, and gasoline prices fell significantly. But in doing so, ethanol prices also collapsed, reducing its competitiveness vs gasoline. At the same time, Bolsonaro indicated that the Renovabio program may be changed which would reduce the Cbios premium paid to ethanol producers, further reducing revenues.

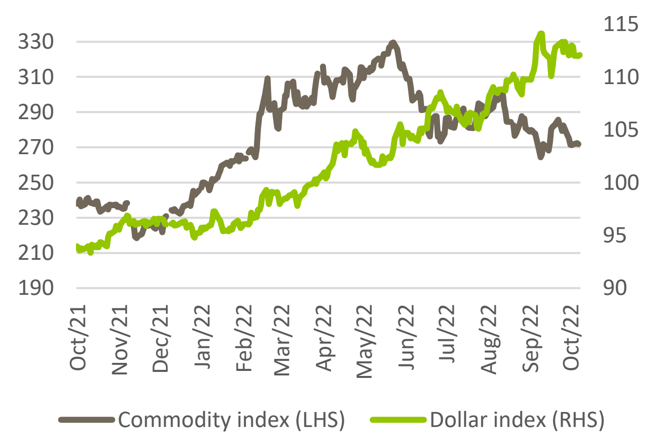
After the elections, we believe that regardless of who wins, ICMS taxes are not expected to return to the old system as such a policy change would need to go to through congress. However, in theory, both Lula and Bolsonaro could easily re-implement federal taxes from January 2023 onwards. We think it is very unlikely though that such a move takes place, as it would be very unpopular in a country that remains strongly divided.

Lula has already given indications that a mechanism similar to the Dilma's administration could be adopted, while Bolsonaro has already informed that Federal taxes will not change in the near future. All in all, ethanol will have a hard battle with gasoline, which will certainly result in lower biofuel prices. In summary, the first view of the next C/S crop points to a strong sugar mix which, combined with the recent rainy weather, may take Brazil back to being the biggest sugar producer in the World.

Macro

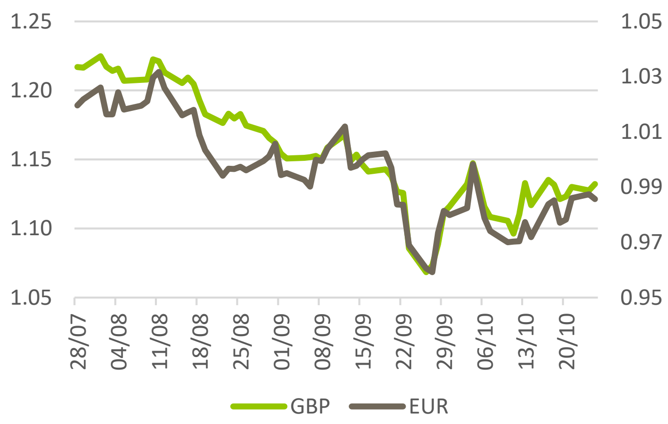
Macro uncertainty continues to dominate markets, with fear of a looming global recession leading to risk-off trading sentiment. The US dollar continued to strengthen in October, keeping pressure on commodities, equities, currencies and bonds alike. Stubborn inflationary pressures continue to keep the Federal Reserve and other central banks on edge, with 2-year US treasury yields soaring to highs of 4.6%, levels not seen since 2008. Around the world, global economic indicators continued to indicate slowing activity and the IMF this month forecast that a third of the world economy will contract by next year. They predicted that global GDP growth next year will slow to 2.7%, compared to a 2.9% forecast in July, as higher interest rates slow the U.S. economy, Europe struggles with spiking gas prices and China contends with continued COVID-19 lockdowns and a weakening property sector.

Figure 7: Dollar keeps soaring



Source: Reuters, ED&F Man Commodity Research

Figure 8: European currencies weaken



Source: Bloomberg, ED&F Man Commodity Research

By many respects, parts of Europe are already in some form of recession. The final quarter of the year was always going to be the toughest, given rising energy bills ahead of winter, and their impact on industrial production. The political shambles in the UK government, which sent gilts soaring, reflects just how hard governments are finding it to handle the most inflationary environment in 40 years. Sterling and the euro have fallen to historical lows versus the US dollar as neighbouring Ukraine continues to struggle with its war.

But stresses are also being seen in Emerging Markets, where the soaring dollar debts are becoming harder to pay. From the Indian rupee to the Chinese Yuan, EM currencies are weakening sharply. China's recent party congress signalled a shift from previous economic expansion targets - to that of Common prosperity – where political ideology is given more emphasis. This suggests that the broader commodities complex can no longer rely on China's economic

expansion to drive incremental demand. Elsewhere in EMs, the Brazilian currency has been naturally very volatile ahead of next week's election. The narrowing gap between the two candidates makes it a difficult race to call, and this has led to fluctuations in the BRL.

Against the backdrop of an increasingly challenging global economic backdrop, it is difficult to see how commodities can sustain their bullish run that began two years ago. Funds are exiting the sector in droves as the strong dollar weighs on sentiment, supply (at least in agri markets) starts to respond, and the cost-of-living crisis leads to demand destruction.

Upcoming Areas of Interest

- **Macro –** Global economic developments
- **LDN 5 –** December expiry
- **Brazil C/S –** Tail of the crop to extend?
- **India –** 22/23 export quota announcements
- **India –** Crop starts as monsoon withdraws

Prices Tab

New York #11					**London #5**				
(cents/lb)	26-Oct	30-Sep	% change		*($/tonne)*	26-Oct	30-Sep	% change	
Mar (23)	17.86	17.68	1.0%	↑	Dec(22)	519.3	528.7	-1.8%	↓
May (23)	16.92	16.94	-0.1%	↓	Mar(23)	488.1	492.0	-0.8%	↓
New York #16					**White Premium**				
(cents/lb)	26-Oct	30-Sep	% change		*($/tonne)*	26-Oct	30-Sep	% change	
Jan (23)	34.35	34.94	-1.7%	↓	Dec/Mar	125.6	138.9	-9.6%	↓
Mar (23)	34.75	34.94	-0.5%	↓	Mar/Mar	94.4	102.2	-7.7%	↓
Macro					**Currencies**				
Indicators	26-Oct	30-Sep	% change		*Against US$*	26-Oct	30-Sep	% change	
CRB	277.3	268.3	3.4%	↑	Euro (EU) *	1.008	0.980	2.8%	↑
Gold	1,664	1,660	0.3%	↑	Pound (GB) *	1.163	1.116	4.2%	↑
Brent Oil	95.69	87.96	9%	↑	Real (Brazil)	5.380	5.415	0.6%	↑
Baltic Dry	1,706	1,760	-3%	↓	Rupee (India)	81.90	81.51	-0.5%	↓
Handysize	940	1009	-7%	↓	Rouble (Russia)	61.25	59.20	-3.5%	↓
					(* rate is US dollars per FX)				