Research

Monthly Sugar Note

30 September 2022

Markets

As has been the case for much of the past months, the market continues to be influenced by macro and Fed developments. The latest US inflation numbers for August (CPI at 8.3%) was above markets expections, resulting in a macro sell-off in anticipation of a large Fed rate hike. A 75-bps hike was priced in for this month's FOMC meeting, which caused the dollar index to soar to fresh 20-year highs. With recession risks on the increase across the world, risk-off sentiment and the strong dollar sent stocks and commodities sharply lower this month.

In the sugar market, the structure is still bullish though, with inverted spreads in both the refined and raws contracts. However, a few factors should be considered for the next months. In the case of whites, the October expiry indicated the market remains desperate for refined sugar. The contract expired on Sep. 15th at 622.8$/tonne, the highest value of a front month contract since 2011. The Oct/Mar spread ended inverted at 79.8$/tonne, a level never seen before, while the White Premium (Oct/Oct) finished at 222$/tonne, also a record.

Figure 1: LDN5 Oct expiry - Origins

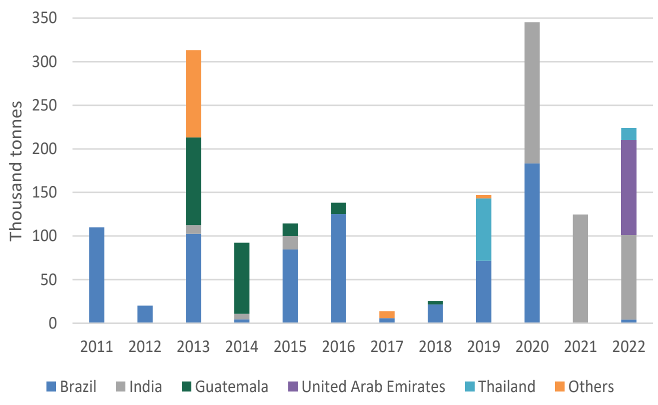
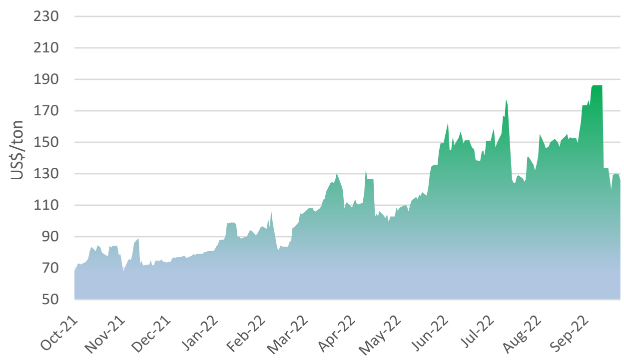


Figure 2: Front month White Premium



Source: Reuters and ED&F Man Commodity Research

Almost 224kt were delivered at the expiry (vs. a historical average of 133kt). UAE delivered 110kt, followed by India with 97kt, Thailand with 14kt and Brazil with 4kt. UAE and India's presence on the tape is a clear indication that the WP is generating good margins at refineries, which should keep chasing Brazilian raws – this is reflected in the growing C/S line ups and firm cash values. The whites market remains tight in part due to the continued absence of Algeria which for the past 6 months has not been supplying the 50kt per month it normally sends to the Med and the African regions. Things look even more tight when factoring this year's poor EU crop where refineries warn that energy supplies may pose additional problems. And all the while, Pakistani whites remain forbidden to the World Market.

Similar to the Oct/Oct WP, the forward WPs remain all elevated, indicating that we are not yet close to finding a solution for the tight refined market. Indian and Thai producers' desire for producing whites may bring some supply side relief, but the large refineries from MENA will still need to work at full capacity.

In the case of raws, we expect whites to continue to drive demand higher, but the recent moves of the Brazilian millers may impact NY11 market fundamentals. Results of the C/S crop during the Second Half of August and First Half of September showed a sugar mix above 48%, the highest value for the period since the 13/14 crop. The latter is due not only to high sugar prices but to the very depressed ethanol prices following the changes in the Brazilian fuel tax system. Hydrous ethanol is trading about 400 points below NY11 at present. Consequently, C/S millers will finish the crop very sugar oriented, which may increase sugar output by 1-2mmt higher than expected at the start of the year.

Assuming normal rains during the C/S summer and ceteris paribus conditions from today's market, the sugar and ethanol prices will result in a C/S sugar output above 35mmt in the 23/24 crop, which will turn the World Sugar Balance into a considerable surplus. India and Thailand can still provide surprises but the results of the Brazilian election which will take place on October 2nd can add volatility to the market. Depending on who wins, Lula or Bolsonaro will have to choose between popularity or balancing Brazil's debts by reintroducing State and Federal Taxes in domestic fuels. The latter would be supportive for prices while the former could make the inversion in NY11 spreads return to carry. Note, however, that the market cannot afford to be much lower than Indian FOB levels over the next 6 months, as the world market needs Indian sugar. But once the new C/S crop starts, ethanol will be the guiding factor once again.

Fundamentals

- **Brazil C/S**: First Half of September production came out with further strong numbers in terms of sugar mix (48% vs. 44.8% at the same time of the past year). This results from the strong advantage sugar presents vs ethanol, which may take sugar output above 33.5mmt in the crop 22/23 crop. The season will certainly be longer than the past crop, with some mills likely to crushing into December. Nominations at C/S ports also continue to perform strongly, although shipments eased a little in September due to rainy weather. The wet weather, while causing delays at the ports, is desirable for the cane fields. Indeed, it has been giving support to a higher cane estimate for the 23/24 season with some houses forecasting numbers close to 600mmt. Additionally, today's prices indicates that the next season may see sugar mix above 46%, which would take sugar output above 35mmt If confirmed, this would be the highest volume since 20/21.

- **India:** The rainfall distribution in India continues to be good in major parts of the Indian cane region. Maharashtra and Karnataka saw cumulative volumes of rain above historical average, but the same cannot be said for Uttar Pradesh. We are currently performing a crop tour in the Maharashtra region. Preliminary results are showing a higher area than anticipated, yet a higher proportion of ratoon cane will implicate results, causing lower agricultural yields. We are expecting production below 35mmt (vs. 35.9mmt in 21/22). Although an increase in our numbers cannot be disregarded, India may not be able to reach the high 36mmt levels that many in the market is projecting. India's stand-alone refineries imported close to 350kt of raw sugar from Brazil in the past two months due to the high White Premium. Meanwhile producers are pressuring the government to announce export quotas - local press suggest the quotas will be made in tranches. Initially a volume of 4-5mmt would be allowed, but a further 1-3mmt could be permitted depending on the results of the crop.

- **Asia:** We are close to the end of Thai 21/22 raws exports campaign, with nearly 95% supply already done by Jan-Aug'22 and no raws vessels lined up this month. Although Australian raws export has been strong during their export season, Asian refineries have to source more raws from Brazil. As for refined, the Thai cash market is tightening after the 14k that will be delivered under LNWS Oct 2022 contract, and Philippines just announcing an import program of 150k refined sugar for Nov'22 arrival.

- **Centrals:** The region remains completely dry in terms of sugar availability, with the majority of the season's exports already done, and still a month or two away from the start of the new harvest. In terms of rains, the region is very wet, with above average rains in almost all months since April. This should result in good cane availability, but may compromise sucrose levels should they continue for longer than average. The region should have a similar level of production YoY.

- **EU/UK:** The latest MARS Agricultural Monitor report for September showed a 2.8% drop in average EU beet yields over the month, the third consecutive report that showed a drop in estimates. Of the main sugar producing member states, France saw an estimated yield reduction of 7.1%, and Germany of 3.4%. Such reductions are a consequence of one of the worst droughts in over 20 years for some parts of the European Union. Despite lower than average beet yields, sugar content is reportedly at record highs, helping compensate towards end sugar yields. However, with rains returning over the past month, we should see some recovery in beet yields at the expense of sugar content. Harvesting begins this month, with varying start dates depending on different member states' gas supplies. In Germany for example, the average start date is 7-8 days ahead of last year.

Focus – US and Mexico

A new crop is about to start in Mexico and the United States and with that, a new cycle of discussions on the region's trade flows, the size of the Mexican export's quota into the US, volumes of sugar to be exported to the World Market and, given the low sugar stocks in the US, which other import mechanisms will be relevant, such as high duty imports.

From the Mexican perspective, the new crop should see a good availability of cane. Rainfall has been in line with or above average for most regions, although in the Northeast volumes were somewhat below average. With these rainfall parameters, Mexico should have another good crop with production above 6mmt of sugar.

Given current volumes of Mexican stocks, projections of domestic consumption and good production, it is expected that Mexico will have approximately 1.6mmt of sugar available for export along the season, but the question is how much of this sugar will be diverted to the US and how much to the world market. Until a few weeks ago, the expectation was that almost all of it would go to the US, but recent updates on the US SnD have reduced this number.

The US SnD projection reported in the latest WASDE report shows increases in the 22/23 ending stocks projection, reducing the need for Mexican sugar. Since the report from June, USDA has already increased the production estimate between the current and next crop by 230k MTRV, raws TRQ by 84k MTRV and high duty imports by an impressive 122k MTRV based on actual shipments. Small increases in demand did not offset it and it ended up resulting in a preliminary Mexican quota of 1469k MTRV (or 1.39mmt). Add to that the refined and specialty quota recently released at 222k MTRV and the need for Mexican sugar reduces further.

Certainly, many moving pieces remain for both countries' SnDs and trade flows, but at the current pace, the quota should reduce, although it should not be less than 1028k MTRV (0.97mmt), which is the minimum guaranteed as per the current Suspension Agreement. Still, Mexico may need to export around 250-350kt to the world market during the new season. But given that a big portion should still reach the US under the Reexport program, the direct impact on the WM trade flow should be smaller.

Figure 3: Mexico – Rainfall (mm)

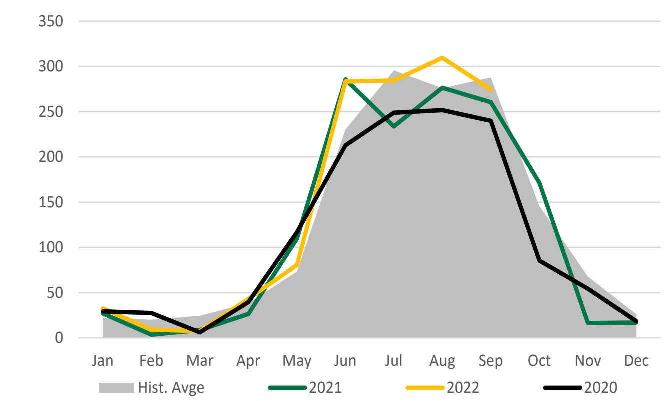
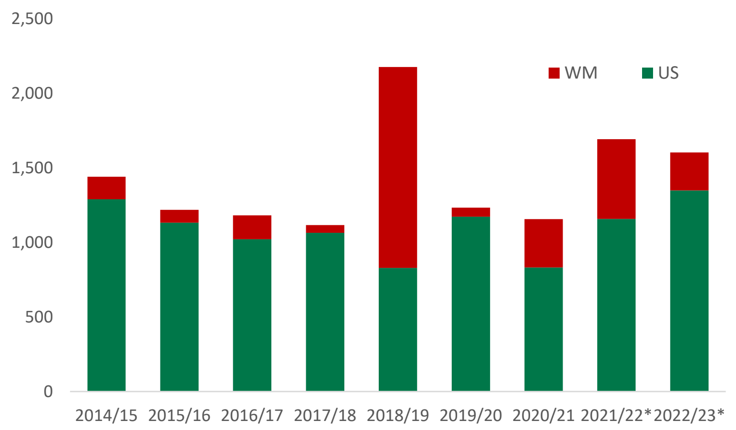


Figure 4: Mexico – Sugar exports



Source: ED&F Man Commodity Research

Macro

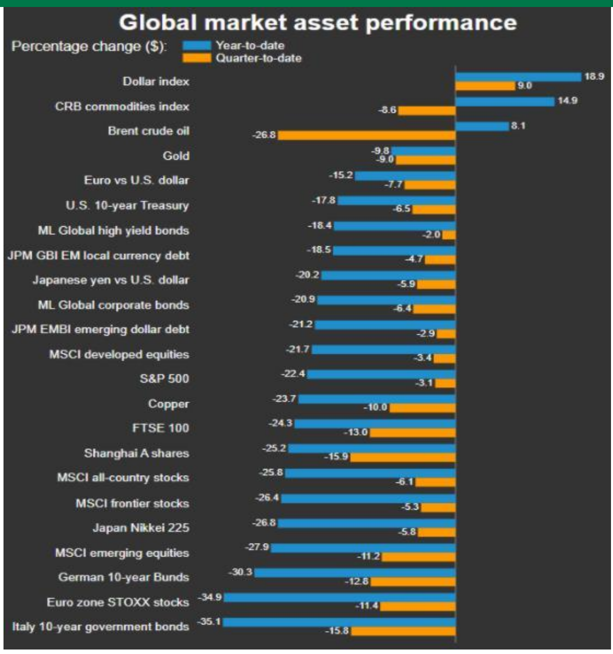
As we approach the end of the third quarter of the year, it is clear that only the US dollar will emerge victorious over the 3-month period, with almost all financial markets and asset classes ending in the red. Commodities, equities, currencies and bonds all suffered in September, as global economic indicators continued to indicate slowing activity. Markets remain nervous over how hawkish central banks are likely to be in terms of tackling inflation, and the focus is increasingly switching from inflationary concerns to that of outright recession.

The US Federal Reserve's 75 bps rate hike in this month's FOMC meeting was in line with jumbo hikes in other major central banks – be it Canada's, the EU's, Switzerland's, England's or India's. Despite narrowing interest rate differentials, the heightened global uncertainty and demand for dollars to purchase much-needed commodities has ensured that it is the dollar that continues to shine. The flight to safe havens has pushed the dollar index to fresh 20-year highs. This in turn is putting stress on Emerging Markets, whose dollar debts are becoming harder to pay down.

Unlike most EM currencies that have been weakening to multi-year lows versus the dollar (eg the Indian rupee fell to record lows of 82), the Brazilian currency has surprised on the upside. The BRL is up 5% in the 3rd quarter, as the Brazilian central bank's aggressive rate hiking cycle comes to an end, having successfully brought inflation under control. The producer price index (PPI) fell 3.11% in August, down from 1.13% in the previous month. Importantly, markets seem to be pricing in a Lula victory next month, who has widened his lead over Bolsonaro to 13 percentage points. Lula has been reinforcing a centrist message to markets, making alliances with market-friendly names and signalling that in his eventual third term in office he will adopt a market-friendly approach on policy.

Recessionary fears have started to weigh on commodities, which are no longer seeing positive investor inflows. While the ongoing Russian invasion keeps European gas prices high, worries about slowing global growth weighed on other raw materials, sending the Bloomberg Commodities Index to the lowest level since February. Dollar strength and diverging interest rate policy has formed a “negative feedback loop” for commodities, whereby market liquidity has fallen, volatility has risen and investor confidence in the bullish commodity outlook has evaporated. Crude oil, for example, fell by 25% this quarter, on fears of falling demand; and although agricultural and soft commodities have been more resilient (thanks to the ongoing La Nina, droughts and low stocks), negative economic fears are now putting pressure on these markets too.

Figure 7: Q3 has been brutal for markets



Source: Reuters, ED&F Man Commodity Research

Figure 8: Yet the dollar keeps firming

Source: Bloomberg, ED&F Man Commodity Research

Upcoming Areas of Interest

- **Macro –** Hawkish FED speech
- **NY11 –** October expiry
- **MENA –** Raw imports and refined exports
- **Brazil C/S –** Crop progress and potential delays
- **India –** 22/23 quota announcements
- **Weather –** Rainfall in northern hemisphere crops

Monthly Sugar Note

29 September 2022

Prices Tab

New York #11					**London #5**				
(cents/lb)	27-Sep	30-Aug	% change		*($/tonne)*	27-Sep	30-Aug	% change	
Oct (22)	18.19	18.10	0.5%	↑	Dec(22)	528.3	521.0	1.4%	↑
Mar (23)	17.59	17.96	-2.1%	↓	Mar(23)	493.1	502.9	-1.9%	↓
New York #16					**White Premium**				
(cents/lb)	27-Sep	30-Aug	% change		*($/tonne)*	27-Sep	30-Aug	% change	
Nov (22)	34.50	35.99	-4.1%	↓	Dec/Oct	127.3	122.0	4.4%	↑
Jan (23)	34.71	36.00	-3.6%	↓	Mar/Mar	105.3	107.0	-1.5%	↓
Macro					**Currencies**				
Indicators	27-Sep	30-Aug	% change		*Against US$*	27-Sep	30-Aug	% change	
CRB	266.0	293.6	-9.4%	↓	Euro (EU) *	0.959	1.001	-4.2%	↓
Gold	1,629	1,724	-5.5%	↓	Pound (GB) *	1.073	1.166	-7.9%	↓
Brent Oil	86.27	99.31	-13%	↓	Real (Brazil)	5.382	5.122	-5.1%	↓
Baltic Dry	1,807	1,017	78%	↑	Rupee (India)	81.71	79.67	-2.6%	↓
Handysize	983	919	7%	↑	Rouble (Russia)	57.90	59.00	1.9%	↑
					(* rate is US dollars per FX)				