Research

Monthly Sugar Note

27 February 2023

Markets

After January’s strong performance across equities, commodities and other markets, macro sentiment turned distinctly lower in February. At the start of the year, markets were buoyed by the perception that a cooling US economy could result in lower Fed rates. However, data in the past month indicated that inflation is still coming in higher than expected. This gave markets a much-needed reality check that the job of the Central Bank is not done and that interest rates will need to move higher. For much of February, the dollar strengthened - and with it, stocks, emerging market currencies and many commodities have come under pressure.

Against this less benign macro backdrop, sugar prices have been resilient, managing to stay above 20c/lb on the back of growing signs of a tight market. As we were expecting, India’s production projection has been revised lower across various sources. The main one, ISMA, reduced its forecast from 36.5mmt to 34mmt and suggested that no more export quotas will be necessary. India’s crop progress results until the first half of February are still tracking above that of the past season, but if our numbers are correct, there will be a sharp end to the crush. We think ISMA’s forecast are too high and do not discount additional reductions to their crop estimates over the next months.

Figure 1: C/S sugar rainfall

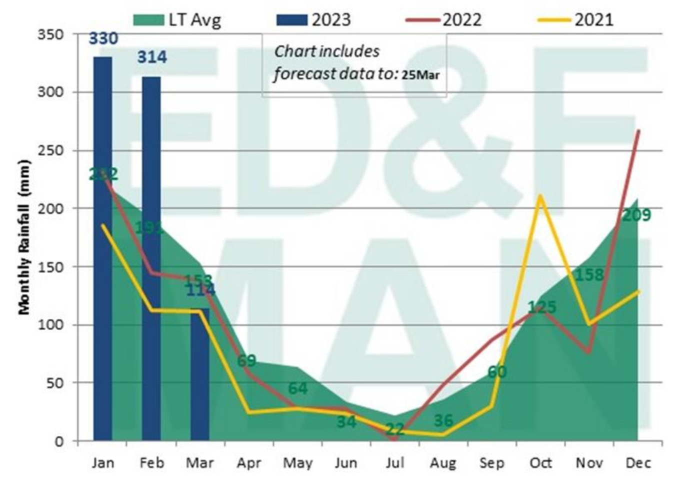
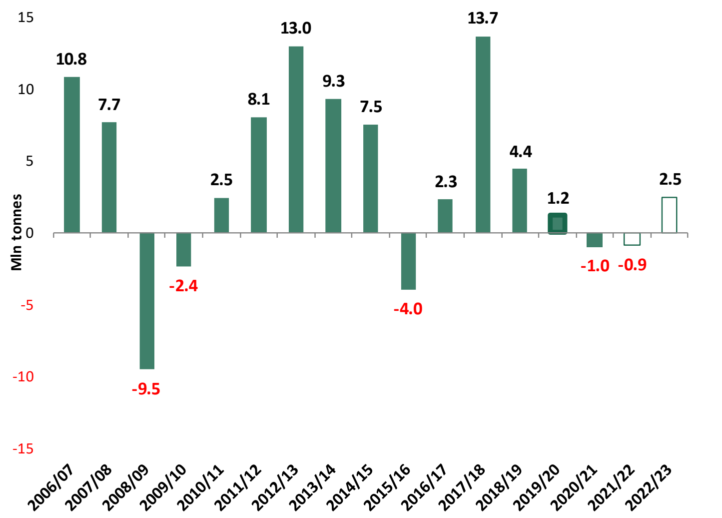


Figure 2: World Market SnD (Oct/Sep)



Source: ED&F Man Commodity Research

Thailand’s crop continues to exhibit good progress, with record sucrose levels observed. But producers are starting to reduce their expectations for the remainder of the crop. The Thai Sugar Trading Corporation lowered their cane crop to 100mmt, which would bring sugar output closer to 11mmt, about

500kt lower than market consensus. We will have to wait for mill closures data over the next few weeks to get a better idea on the crop situation there.

Mexico's crop estimate was reduced by the government from a previous 6mmt to 5.8mmt. Crop progress figures are coming in at the lowest of the past 4 crops, which means a final crop close to 5.5mmt should not be dismissed. Mexican sugar was already out of the World Market, but we may now see Mexico being unable to meet 100% of the US quota either, which may necessitate more imports from the World Market.

Fortunately, in the all-important Brazil, rains continue to be abundant in the Centre/South. February precipitation in C/S cane fields should end up close to 300mm, 50% higher than the historical average for the month. Producers haven't reported any negative impact on cane development so far, but grains exports (which are set to be massive this year) are being delayed. This has the potential to make sugar/grains port competition quite intense in the first months of the C/S Brazil season. We should also mention that the new government has announced a return of Federal Taxes in March, which will raise fuel prices and support hydrous values.

Last but not least, after several years of La Niña, El Niño is consolidating its formation and may arrive by mid-year. This will make the Thai and India off-season period drier than usual, and the C/S harvest wet at a time when Brazil is the only source of sugar to the market. All in all, given the above fundamental factors, we find it hard to see sugar prices falling over the next months (unless macro turns even more negative, which remains a possibility). Moreover, the much-anticipated "surplus" for the 22/23 crop is only likely to show its face at the end of the season.

The refined sugar contract of March expired with a total of 190kt tendered in two different Indian ports. The volume ended being lower than the historical average of the contract, at close to 240kt. The March 2023 expiry confirmed India as, yet again, the main source of refined sugar to the World.

Fundamentals

- **Brazil C/S:** As expected for the peak of the intercrop period, January production in C/S Brazil was low, with just 36kt of sugar produced. This led to a total of 33.5mmt produced by the end of Jan, up 4% YoY and on track to reach our forecast of 33.8mmt until the end of March. So far, the rains have been very satisfactory for the cane fields, with good volumes and distribution across the C/S region. It is important that this pattern remains for the next few months to support our 7.3% growth expectation. We currently estimate cane crush of 592mmt which, with a sugar production mix of 47.0%, results in 37.1mmt of sugar production, almost 10% higher than 2022/23. Exports remain relatively strong, given the time of the year and low level of stocks. Good demand and rainy conditions continue to keep the line-ups full. Ports are preparing for a busy year ahead with heavy competition between grains and sugar. On the political side, an important decision is expected for March 1st, when the return of federal taxes on fuels is set to be reinstated. This will increase fuel prices, but mostly gasoline, increasing the competitiveness of hydrous ethanol. Although this could be supportive for ethanol prices, they remain significantly below sugar parities; and our view for a max sugar crop ahead remains.

- **Asia:** We reduced Thailand's cane crush estimate to a range of 102-106mmt. Although slightly offset by increasing our sugar yield number, this has resulted in an overall downward revision in Thailand's sugar production to below 12mmt. The revision is on the back of us completing a satellite analysis that showed a faster shrinking of harvested area than expected, and more mills talking about lower area. Moreover, cane crush numbers are also showing a slowdown after accounting for mill maintenance. On raws demand, there are continued concerns from Indonesia over too high a flat price and slower than expected pace of import license issuance. Overall, the high price environment is doing its job in rationing demand from a very tight market due to the lack of further exports of Indian sugar.

- **Centrals:** Central American mills are around halfway done with their crush for the current season and the results from the fields are so far in line with market expectations. El Salvador had a delay at the beginning of the season and sugar production up to Feb 19th reached 458kt, compared with 523kt at the same period last year. However, yields are at similar levels YoY. Guatemala had a smaller delay at the start of the season by comparison, and up to Feb 13th has produced 1.48mmt of sugar vs 1.52mmt the year before. Exports continue to be the highlight of the season for the region, with a strong pace noted across both refined and bulk raws, supporting the notion that the regional market is tight.

- **US:** The February WASDE report had very small changes: a reduction of 15k MTRV on production (made up of +47k MTRV on beet sugar, offset by a cut of 62k MTRV in cane sugar). With that, the current US SnD presents a surplus of around 160k MTRV. The next March WASDE report will set the final import quota from Mexico. Fine tuning of other SnD components is also expected, but assuming now other change, the surplus would be solved by reducing the Mexican quota. The USDA is currently working with 5.9mmt for Mexico but will probably reduce this estimate - the limiting factor for the quota being Mexican availability for markets outside of US needs. This means we could see early reallocation of TRQ's shortfalls this season, and the potential for extra regional demand (which is already heated this season).

- **Mexico:** Around 50% of the crop has now been processed and the figures are not promising. Agricultural yields are 11% lower YoY and sucrose is down 3%, resulting in sugar production per hectare 14% lower. Up to Feb 18th, 2.58mmt of sugar were produced vs 2.80mmt the same time last season. Unlike the past season, when Mexico exported over 500kt to the World Market, we do not see Mexican sugar competing with Centrals and Brazil in 2023.

- **EU/UK:** While the cold weather periods of Jan and Feb saw below freezing temperatures, any damage to 22/23 crop will be minimal due to the harvest period being nearly over. Forecasts suggests another cold snap in early March across the beet belt, which would help reduce the aphid population, in a season in which Neonic exemption has just been receded. With the pesticide unavailable we have re-evaluated the planting area for 23/24, and due to producers offering higher beet prices in order to convince farmers, we expect a 0.5-1% increase in area. Using average yield, this would mean output close to 16mmt, an increase of 0.5mmt from 22/23.

- **CIS:** Ukraine sugar continues to flow into Eastern Europe at impressive levels but is now competing further afield in the south-west of EU, such as Spain. For the 23/24 season planting area could increase by as much as 30%, raising production to 1.5mmt. If conflict in Ukraine is not resolved and the quota free access is delayed beyond into next season, this would mean that even more sugar will likely enter Europe.

Focus – India

We were the first trade house to flag India's potential crop being low following two extensive crop tours. Back in December 2022, we were estimating the crop at 32.4 MMT India crop, at a time when our peers were seeing them at 35-36 MMT. Over the past few weeks, however, the market has been gravitating towards our numbers, with a new consensus emerging around the 33-33.5 MMT mark. The production optimism was not misplaced to be fair, as India's crop progress results have been coming in strong season-to-date. Indeed, India produced a cumulative total of 22.82 MMT of sugar until 15th Feb, higher than the 22.2 MMT during the same time last year. However, this is because mills are crushing at a higher pace vs last year because of increased capacity, but also due to the early start of the season in anticipation of lower cane availability in some areas. We expect this strong pace to slowdown soon.

Indeed, in Maharashtra, sugar production up to 26th Feb is 9.47 mmt, vs 9.7 mmt at same time last year. Out of the 204 mills in operation this season, 46 mills in Maharashtra have ended their crushing so far, compared with no closures during the same time last year. We estimate the state's production will end at around 11.26 mmt. In Karnataka, sugar production up to 15th Feb was 4.6 mmt (expected at 4.94 mmt up to 28th Feb) vs 5 mmt last year. In Karnataka, out of 72 mills in operation this season, 38 mills have ended crushing, vs 7 mills that were closed the same time last year. We expect the remaining mills to close within 10 to 15 days (except for 2 or 3 mills in South Karnataka). Our estimate for this state is 5.29 mmt of sugar production. In Uttar Pradesh, sugar production up to 23rd Feb is 6.59 mmt (expected at 7 mmt up to 28th Feb) vs 6.85 mmt at same time last year. Out of the 117 mills in operation this season in UP, 6 mills have stopped crushing vs 8 mills that closed last year at the same time (from the eastern parts). We are currently doing a crop tour in UP; as per our tour findings so far, agri yields are coming down as expected. However, mills are observing higher harvest areas due to lower diversion towards jaggery units. The trend of sugar recovery is down from our estimate, however. As such, we could see a higher cane crush number, but lower sugar recovery - giving a new estimate for Uttar Pradesh of 10 MMT.

With the lower production, the government will not be allowed the additional export quota. Out of the 6.09 MMT of export quota, so far around 5.8 to 5.9 MMT of sugar has been contracted as per trade sources. More than 4 mmt sugar is physically exported in various qualities. If our crop number is realized, we foresee tight domestic availability.

Figure 3: India fortnightly sugar production to 15 Feb 23

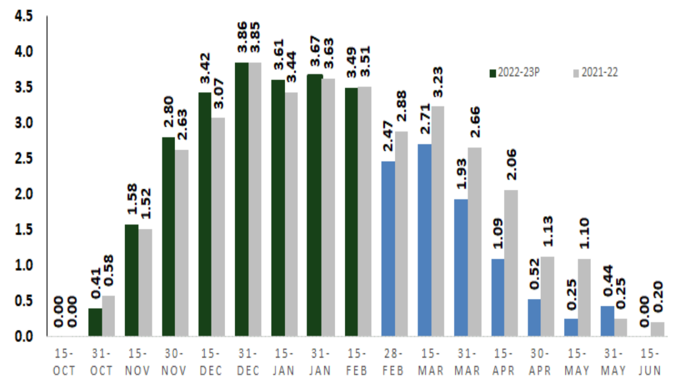
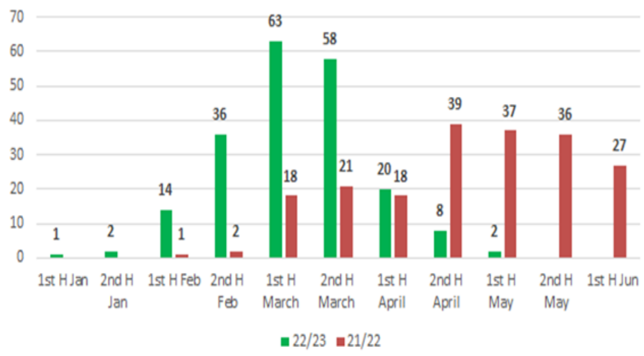


Figure 4: Maharashtra mill closures vs last year



Source: ISMA and ED&F Man Commodity Research

Macro

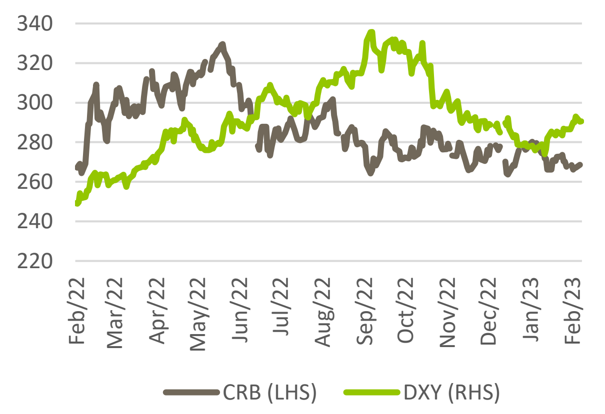
A year on from the Ukraine war, the world is still suffering from inflation and rising interest rates. While commodity prices have fallen back to pre-war lows, most developing countries are still suffering from the aftermath of high energy and food costs and the strong dollar. The latter is showing signs of recovering again as markets price in a "no landing" global economic scenario, where global economic growth is resilient, and inflation stays higher for longer.

Macro risk appetite for both risky assets such as equities, commodities and Emerging Markets, as well as for government debt, took a negative turn in February. For months, investors had been betting on global growth softening just enough to cool inflation and persuade hawkish central banks to pause their rate hikes. The notion of Fed and other central banks using monetary tightening to engineer a mild, soft landing before pivoting to avoid a deep recession had supported a cross-asset rally since October, depressed the dollar and sent capital flowing into emerging markets. This led to January being a very strong month for Macro. But recent data reflecting still tight jobs markets has traders entertaining a new scenario where economic growth holds up and inflation remains sticky. That means rates could be pushed higher too - a negative for risk assets. In view of the strength of both the US and Euro-zone economies – along with sticky inflation - investors have now ditched expectations for rate cuts later this year and have renewed their bets on higher rates. US rates are now seen peaking in July at about 5.5%, up from about 4.8% in early February, while European Central Bank rates are seen rising to 4%, levels not seen since before the financial crisis of 2008.

The inflationary environment remains hinged to the war in Ukraine, which sent energy and food prices soaring 12months ago. Rising commodity prices not only inflated costs around the world, it also particularly hit low income countries, most of whom are sugar destination markets, import dependent, and who have been suffering from a serious lack of dollar liquidity. The soaring dollar has impacted these LICs' debt stress levels, many of whom are now applying to the IMF for help. Although commodities are back to pre-war lows, the Ukraine/Russia war, now in its 1-year anniversary, could again see a geopolitical risk premium develop due to the lack of resolution in this vital conflict region. Crude oil, in particular, is forecast to rise to $90/bbl+ as Russia curbs oil supplies and China's reopening prompts greater demand for energy.

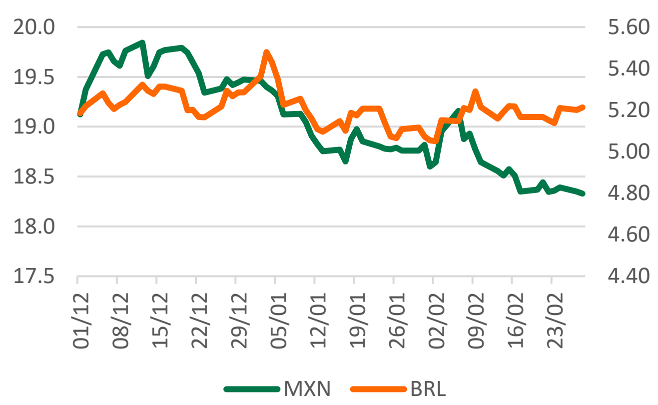
With the dollar firming to 7-week highs on the back of the higher than expected inflation in the US, other currencies, notably the EUR and JPY have weakened from their January highs. The BRL has been particularly volatile this past month. On the one hand, support has been coming from attractive carry-trade inflows into the BRL, which has been trading either side of a wide 5.01-5.43/USD trading range. On the other hand, the BRL has been under pressure from the stronger dollar as well as tensions between the Lula government and the Brazilian central bank over inflation targets, the level of interest rates and its independence. Political uncertainty may continue to add volatility to the currency over the next few months.

Figure 7: Dollar rebounds again



Source: Reuters, ED&F Man Commodity Research

Figure 8: The BRL has been underperforming



Source: Bloomberg, ED&F Man Commodity Research

Upcoming Areas of Interest

- **Brazil C/S –** Weather developments at the end of the intercrop
- **India –** ISMA crop projection updates
- **India –** Export quota to be revised?
- **Thailand –** Crop number updates as mills start to wind down operations
- **Weather –** El Nino evolution

Prices Tab

New York #11					**London #5**				
(cents/lb)	27-Feb	30-Jan	% change		*($/tonne)*	27-Feb	30-Jan	% change	
Mar(23)	22.09	21.21	4.1%	↑	May (23)	571.3	560.7	1.9%	↑
May(23)	20.29	19.90	2.0%	↑	Aug (23)	555.5	543.5	2.2%	↑
New York #16					**White Premium**				
(cents/lb)	27-Feb	30-Jan	% change		*($/tonne)*	27-Feb	30-Jan	% change	
May(23)	37.24	36.90	0.9%	↑	May/May	124.0	122.0	1.6%	↑
Jul(23)	37.24	36.90	0.9%	↑	May/Aug	108.2	104.8	3.2%	↑
Macro					**Currencies**				
Indicators	27-Feb	30-Jan	% change		*Against US$*	27-Feb	30-Jan	% change	
CRB	268.6	274.4	-2.1%	↓	Euro (EU) *	1.061	1.084	-2.2%	↓
Gold	1,817	1,923	-5.5%	↓	Pound (GB) *	1.206	1.235	-2.3%	↓
Brent Oil	82.45	84.90	-3%	↓	Real (Brazil)	5.201	5.116	-1.7%	↓
Baltic Dry	935	721	30%	↑	Rupee (India)	82.64	81.52	-1.4%	↓
Handysize	517	433	19%	↑	Rouble (Russia)	74.92	69.90	-7.2%	↓
					(* rate is US dollars per FX)				