ED&F MAN Research

Monthly Sugar Note

31 March 2023

Markets

The emerging banking crisis dominated headlines this past month as the rapid rise in interest rates finally began to take its toll. The first casualty was the Silicon Valley Bank which collapsed after loss of deposits and exposure to government bonds that had been losing asset value alongside rising interest rates. Later, Credit Suisse, beset with pre-existing problems, had to be rescued by the Swiss National Bank and merge with UBS.

Central banks around the world have been raising the cost of borrowing to try to dampen down rising prices. But the emerging banking crisis has made the job of central banks hard. Inflation remains high, requiring tighter monetary policy. Yet increasing rates may damage the fragile economy. For now, both the European Central Bank and the Fed chose to stay the course, raising rates by 50 bps and 25 bps respectively this month. However, their forward guidance was more dovish than before as they are clearly worried that credit stress could have deflationary effects. This suggests that we may be nearing peak rate values in the short term.

In the midst of all this banking and bond market turmoil, commodities and equities fell sharply. Crude oil suffered the most amongst commodities, with WTI falling below $70/bbl. Sugar prices, however, remained resilient to the macro sell-off. Supportive fundamentals in the past month (following lower crops around the world) kept prices in NY close to 22c/lb.

Figure 1: Oil vs. sugar prices

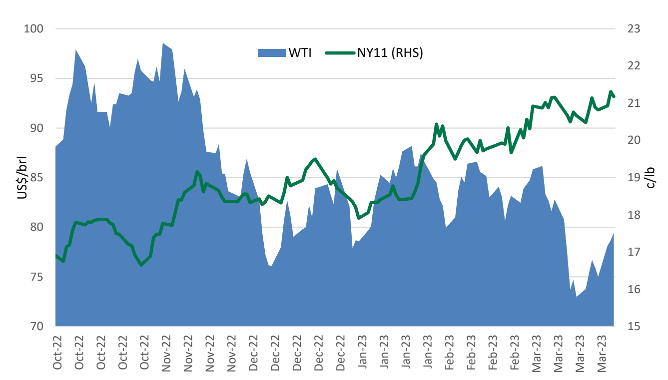


Figure 2: White Premium – May/May

Source: The Ice and ED&F Man Commodity Research

India's sugarcane harvest is finally reflecting the much-expected poor tail of the season in Maharashtra. The latest production figures from ISMA up to mid-March showed for the first-time lower sugar output

YoY. Moreover, the number of the mills that have stopped crushing is increasing rapidly, reaching 194 in the period, about 150% higher than the same time of the past crop.

Thailand proved again that analysts need to find better ways to estimate the local crop. Unlike original market expectations of a crop close to 12mmt - and given that out of the 57 mills, 54 have ended the harvest (up to March 30th) - Thailand is now expected to produce less than 11mmt of sugar this season. While this is still 1mmt higher than the previous crop, at a time of lower supplies from India, it was a bullish surprise.

Mexico, China and Centrals are also seeing lower crop figures YoY, which means the world market is now increasingly dependent on the CS Brazil crop. Brazil's weather has been good and cane growers are pleased with their cane development. However, Brazil needs to prove that it can crush a volume close to 600mmt until the end of the year without any weather or export disruptions. The latter may prove challenging given the large grain crop expected in Brazil and the coming El Niño weather phenomenon.

In summary, fundamental trends remain constructive for the next month and we don't see much scope for this market to fall, unless Brazil proves it can supply the entire market without hiccups. One factor to be watched is China's desire to import. The import parity is still closed but in case NY falls below 20c/lb, China is expected to come to the market and stem any price drop.

Last but not least, with the end of the Indian and the Thai crops, the whites market is getting substantially tighter. Egypt has joined Algeria in banning sugar exports, the Dubai refinery remains below capacity and the EU crop outlook looks increasingly uncertain following the ban of neonic chemicals and smaller area increase. These developments have caused the deficit in the Med and Africa regions to become even tighter, resulting in firming white premiums. The May/May white premium is now above to $140/t, meaning that stand-alone refineries may have to come to the rescue.

Fundamentals

- **Brazil C/S:** As we get to the last days of the official 2022/23 season, producers' attention remains on the weather forecast. While the rains have been very positive for cane development for the new campaign, now the producers need a good window of dry days to be able to start the harvest for the new season. Given the attractive prices, high demand, good cane availability and low sugar stocks, millers intend to start the harvest early this season, weather permitting. April forecasts have been volatile, but currently indicate a dry window, which should allow the 2023/24 crop to kick-off. Despite the partial return of the federal taxes over fuels (mostly gasoline), which was a positive factor for hydrous, it wasn't enough to cause significant impact on sugar vs ethanol price parities. As such, producers should continue with their plan to focus on sugar production as much as they can. Exports in March remain relatively strong for the period, particularly given the low level of stocks. The logistics competition with grains remains an important flag for the next months as soybean exports also got delayed with the rainy weather at the ports.

- **India:** Over the past few weeks, the market has been gravitating toward a crop figure of under 33mmt, a number we had been working with ever since our crop tour in December. India's sugar production to 15th March is 28.18mmt, -1% down from last year. On a cumulative basis, sugar production is down by -270kt compared to the same time last year, and on fortnightly basis, down by -675kt compared to last year's same fortnight. In the fortnight to 31st March, the expected drop in production on a cumulative basis is around 1.3mmt and around 1mmt lower sugar production on fortnightly basis compared to the same time last year. Out of the 208 mills in operation this season, 162 Mills in Maharashtra have ended their crushing so far, compared with 22 mills that were closed during the same time last year. In Karnataka, out of 72 mills in operation this season, 65 mills have ended crushing. In Uttar Pradesh, out of the 117 mills in operation, this season in UP, 11 mills have stopped crushing vs 16 mills last year at the same time. With the lower production, the government will not be allowed the additional export quota. Out of the 6.09mmt export quota, so far around 5.9mmt of sugar has been contracted as per trade sources. More than 4.9mmt of sugar is physically exported in various qualities. With the lower sugar output, we should expect tight domestic availability.

- **Centrals:** Central American mills have reached the final weeks of production and the result from the fields so far remains in line with our estimate of 5.0mmt, a 1.3% reduction YoY. El Salvador's crop was delayed at the beginning of the season and sugar production up to March 19th reached 610kt vs 679kt at the same period last year. Despite good yields, sucrose levels are below last season's and the country could see a small drop in production on the year. Guatemala's production up to March 19th has reached 2.0mmt of sugar vs 2.1mmt the year before. The pace of nominations remains very strong, and shipments are performing well. As a result, there is regional tightness, with little volume left to be exported in the final months of the season.

- **US:** A busy month for the US market with the much-awaited March edition of the WASDE report and the reallocation of the raws TRQs. The WASDE report increased production by 72k MTRV and raised TR2 imports by 28k MTRV. This leaves room for further import increases, although consumption gains should offset part of the additional supply. All in all, in order to reach the desirable level of 13.5% stock to use ratio, USDA reduced the Mexican quota to the now official level of 1185k MTRV (1118kt tq). Given the poor crop in Mexico, it is unlikely that Mexico can contribute more than this volume. As such, the USTR has already announced the reallocation of 224k MTRV of raws TRQ shortfall which should be mostly used, adding to the US raws supply. Still, domestic prices and the feeling of local tightness remains very high.

- **Mexico:** Around 60% of the crop has now been processed and the figures continue to disappoint. Up to March 18th, 3.6mmt of sugar were produced vs 3.9mmt same time last season, a 7% drop YoY despite the larger area harvested, at +7% YoY. This is due to agricultural yields being 12% lower and sucrose 2% lower YoY, resulting in sugar production per hectare some 14% lower. Given this, we don't expect production to surpass 5.5mmt.

- **EU/UK:** Good rains and high temperatures for this time of the year give us little indication on the next crop outlook. For the time being, the market is working with a production level close to 16mmt which assumes a small area increase of 1% and historical yield averages. Temperatures have started to increase, which may result in higher need for chemicals to control the yellow virus development. However, only UK producers are allowed to use neonic products, given the ban in the EU(27). Latest exports figures for Nov/22 and Dec/22 showed 186kt of refined exports, almost half of the volume exported at the same period of 2021 (286kt).

- **CIS:** Ukrainian production continues to flow to the EU(27), totalling 42kt in Feb/23. The EU(27) zero import tariff to Ukraine has been extended to Mar '24 which will guarantee good demand for Ukrainian production. The country plans to increase its beet area to 220k ha, about 30k ha more than in the past season which may lead to sugar output being close to 1.5mmt.

Focus – Thailand

Thailand's sugar crop of 22/23 started with an optimistic tone back in mid-2022, with ample rains in both the planting period and growing season. This was in stark contrast to the poor crops of 19/20 and 20/21 which were hit by a lack of rainfall during critical periods. Sugar supply in Thailand was desperately needed after two consecutive poor crops. Estimates in Aug 2022 showed various agencies penning the crop at 103-110mmt of cane with a good yield of 63-68 mt/ha. The crush started well with dry weather in December aiding the harvest pace with peak crush exceeding last year levels in January. However, the end of February saw crush rates beginning to fall and mill planned closures starting to happen earlier than the market expected. By mid-March, the short tail of the Thai crop became obvious and various market indications for cane at 100-105mmt back in February were downgraded to <95mmt by end March.

There are a few possible reasons why the 22/23 season, which had so much promise, ended up worse than expected. The first is the lack of fertilizer application due to high fertilizer prices in 2022 after the Ukraine-Russia war. This resulted in cane stalks that became thinner than usual with reduced stalk yield. The second is the lack of rainfall during harvest which reduced cane yields even further, although this had the offsetting impact of concentrating the sucrose in the cane, resulting in a high sugar yield.

Figure 3: Thai crushing ends early

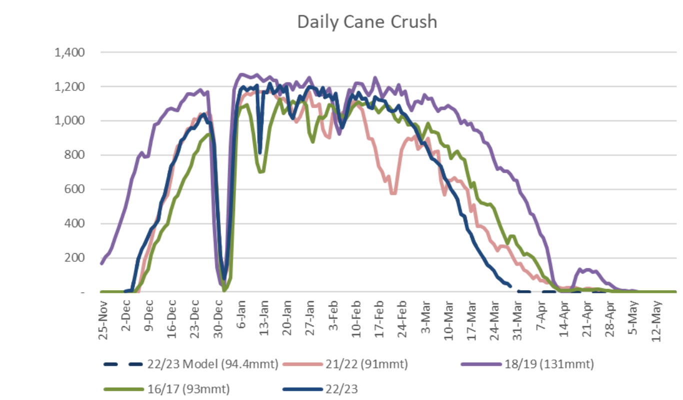
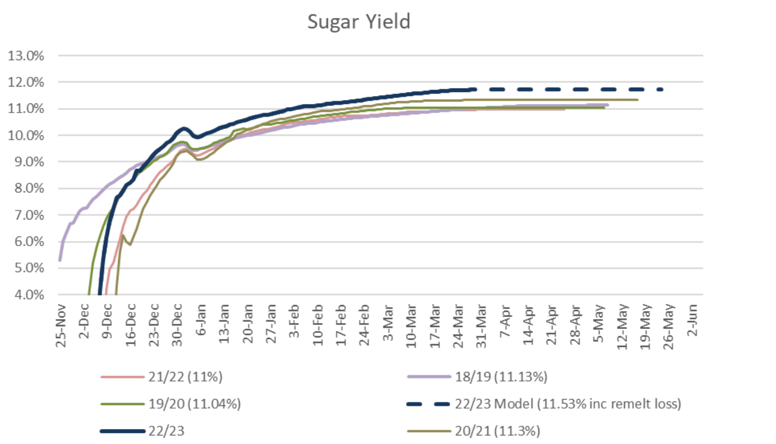


Figure 4: Thai sugar yields are high though



Source: ED&F Man Commodity Research

At the end, the 22/23 crop season should have a sugar production of 10.6-10.7mmt, which is only 8% more than last year's sugar production of 9.84mmt. Production continues to be concentrated in the white and refined sugar quality due to attractive white premiums and strong regional demand from destinations like the Philippines. As a result, supply for raws exports continue to be limited. This is causing raw sugar premiums to remain very high, especially in a year where Indian raws supply is also constrained.

Looking forward to 23/24, record high cassava prices should continue to incentivise farmers to plant more cassava instead of cane. Rainfalls thus far in 2023 has also been lacking, with the threat of El Niño looming as well. This might have the impact of reducing cane yields should rains not come in time for the critical growth period. Overall, the situation for Thailand's sugar production in 23/24 might look to be at best equal to 22/23 with various risks factors pointing to possible further downside. Rainfall in Q2'23 will be an important factor to monitor in the days ahead.

Macro

The first quarter of 2023 was marked by evidence of sticky inflation, signs of trouble in the banking sector, and a repricing of interest rate expectations from the Fed. The past month saw huge volatility in the equities and bond markets following the mini banking crisis, with the fear index "VIX", spiking higher, although commodity prices managed to eke out some gains. The latter was most likely due to the weaker dollar and ongoing signs of China's recovery from Covid lockdowns.

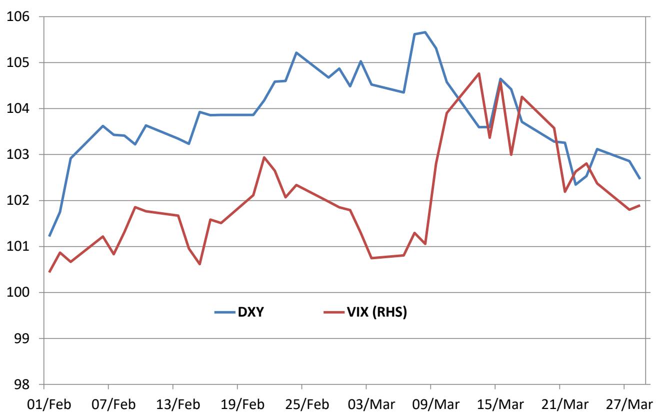
As we enter Q2, the economic outlook will be driven by the ongoing fight against inflation, what central banks choose to do with regard to rates path, as well as potentially tighter credit conditions. The latter stems from the banking turmoil described in the Markets section, followed by huge outflow of deposits from smaller banks in the US and Europe to larger banks and money market funds. As small domestic banks are responsible for the majority of lending, there is risk of a credit crunch if loan behaviour changes as small- and medium-sized banks try to preserve liquidity. Although central banks and the big investment banks have done a credible job in preventing a broader banking contagion, the tightening of credit standards in recent months is likely to accelerate, weakening future loan growth and weighing on economic activity.

A potentially slowing economic outlook is indeed being reflected by the yield curve. The spread between the 2- and 10-year US Treasury bonds has remained negative from July 5 till March 27, with the yield curve's inversion the steepest in more than 40 years. History suggests normalization of US Treasury yield spreads - their return to positive territory - could be followed by a slump in world GDP. There were five occasions in 1980-82, 1990-91, 2000-01, 2007-08 and 2020 that showed similar patterns. If history is a guide, we could see a downturn soon.

Figure 7: Inverted yield curve spells trouble

Source: Reuters, ED&F Man Commodity Research

Figure 8: The VIX retreats, as dollar weakens



Source: Bloomberg, ED&F Man Commodity Research

The dollar has lost some of its lustre from last year. It fell 1.3% this quarter, after notching its biggest annual gain since 2015 in 2022. The twin supports of its status as the preferred haven during the pandemic, and being backed by the world's strongest economy, are fading. Further support for the USD is wobbling amid doubts about how much higher the Fed will raise rates and an expected US economic slump. A weaker USD will be bullish for both commodities and the Brazilian real. The latter had been range-trading between 5.20-5.30 for much of the month; but managed to strengthen 4% over the quarter. A strong rally in the past week was prompted by the new government's much awaited proposal for new fiscal rules to balance limits on spending growth with the government's vow to boost social programs and public investment.

A weaker dollar will also support commodities, with crude oil expected to continue to rebound from recent lows as markets reprice expectations of Fed rates. A less hawkish rates outlook would support risk-on behaviour across futures markets, whilst supporting global economic demand for energy. Along with China's post Covid resurgence in commodity demand, structural supply/demand imbalances in crude oil should remain supportive for prices.

Upcoming Areas of Interest

- **May refined contract expiry**
- **Brazil C/S –** Start of the crop
- **Brazil C/S –** Ports efficiency
- **India –** Exports evolution
- **Weather –** El Nino evolution

Prices Tab

New York #11					**London #5**				
(cents/lb)	30-Mar	28-Feb	% change		*($/tonne)*	30-Mar	28-Feb	% change	
May (23)	21.96	20.07	9.4%	↑	May (23)	630.7	562.4	12.1%	↑
Jul (23)	21.50	19.58	9.8%	↑	Aug (23)	615.6	550.0	11.9%	↑
New York #16					**White Premium**				
(cents/lb)	30-Mar	28-Feb	% change		*($/tonne)*	30-Mar	28-Feb	% change	
May (23)	39.25	37.24	5.4%	↑	May/May	146.6	119.9	22.2%	↑
Jul (23)	38.80	36.99	4.9%	↑	Aug/Jul	141.6	118.3	19.7%	↑
Macro					**Currencies**				
Indicators	30-Mar	28-Feb	% change		*Against US$*	30-Mar	28-Feb	% change	
CRB	264.4	269.8	-2.0%	↓	Euro (EU) *	1.090	1.058	3.1%	↑
Gold	1,980	1,827	8.4%	↑	Pound (GB) *	1.238	1.202	3.0%	↑
Brent Oil	79.27	83.89	-6%	↓	Real (Brazil)	5.094	5.237	2.7%	↑
Baltic Dry	1,403	990	42%	↑	Rupee (India)	82.08	82.64	0.7%	↑
Handysize	691	536	29%	↑	Rouble (Russia)	77.27	75.05	-3.0%	↓
					(* rate is US dollars per FX)				