Research

Monthly Sugar Note

31 May 2023

Markets

Commodities markets sold off in May on the back of tensions relating to the US's $31 trillion debt ceiling. The impasse between the Democrats and Republicans to reach an agreement to prevent the US economy from defaulting on its debt led to a collapse in US bonds and stocks and a rise in safe havens (ironically including the US dollar). In commodities, funds looked to reduce their exposure as they took risk off the table, hitting the likes of crude oil and copper particularly hard. Lacklustre economic data out of China did not help matters, as did the mixed messaging from Fed speakers, who maintain that the US economy is "not out of the woods" given sticky core inflation - indicating rates may stay high for a while.

Amidst this turbulent macro environment, the sugar rally we saw in April ended. NY fell 3.7% from end April to May 26th. Adding market pressure was the improvement in weather in the main sugar producing origins (although it should be noted that El Niño has yet to appear, despite the likelihood of it happening only getting stronger).

Figure 1: C/S Brazil sugar output

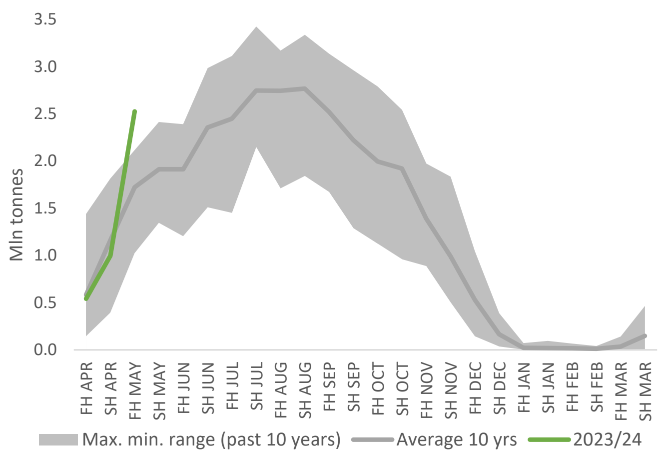
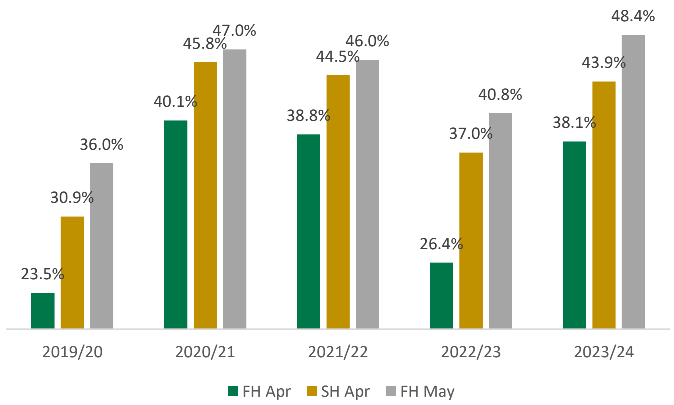


Figure 2: C/S Brazil sugar mix evolution (%)



Source: UNICA and ED&F Man Commodity Research

The dryness observed in May in the C/S Brazilian cane belt resulted in strong production figures. Up to mid-May, the C/S crushed 79mmt of cane, almost 25% ahead of last season, with sugar output of 4.1mmt, 48% higher YoY. As expected, millers are extracting as much sugar they can with a sugar mix close 46% levels (vs. 38% in the previous season). Even the prior rainy days of April appear to have done minimal damage to logistics, with only a small delay in shipments seen, and a still impressive vessel line up.

Disclaimer: Any comments or opinions in this report are not intended to be an offer to buy or sell commodities or futures and options thereon as they merely state our views and carry no guarantee as to their accuracy.

© ED&F MAN 2023

Perhaps more important than the crop progress was the Brazilian government announcing a new pricing policy, whereby fuel prices will no longer be entirely dependent on international prices. The govt cut gasoline prices by R$0.40/litre, which hit the ethanol market sharply, causing hydrous to fall by 17% since the start of May. As a result, sugar is paying close to 10c/lb more than hydrous, the highest value since 2011, when NY11 was close to 35c/lb. To note though, the reduction in gasoline prices is more related to falling oil prices and stronger BRL, as the government has offered little transparency on how the fuel price policy will work in the future.

In Thailand, welcome rains have returned, while in India weather prospects appear to be good for the moment, with the monsoons set to be only slightly below normal. This has reduced the risks of a poor Asian production number at the end of the year. Still, the market believes that Thailand will be unable to produce more than 9mmt of sugar in the coming season, while India will have to allocate an additional 1mmt of sugar to ethanol. This means that while the good C/S Brazilian crop should be able to meet world demand for the duration of its crushing season, the world market will still need to resolve the large projected deficit once the Northern Hemisphere crops take over, from 2024.

Other highlights for the month include Sudan's civil war, which initially impacted the White Premium, and the outlook for the next European crop. After an initial dip in the WP, refined markets are recovering again as sugar flows again to East Africa. Mixed conditions, with dry weather in the south of Europe and wet weather in northern Europe, are indicating lower yields for the south and late planting in the north (despite decent soil moisture). Conditions for yellow virus development in France are also high and the number of cases are starting to surge, which would keep European exports away from the Med region.

Given all the above, we see the uncertain macro scenario and the good Brazilian crop (with limited logistical concerns for now) adding downward pressure to prices in the short term. But just like US inflation, the sugar market is "not out of the woods"; we still need to solve the deficit for the World Market in 2024.

Fundamentals

- **Brazil C/S:** Sugarcane crushing and sugar output in the C/S beat market forecasts in the First Half of May. According to UNICA, the main cane region of Brazil crushed 44mmt of cane in the period, almost 30% higher YoY. Sugar mix ended at 48.4% (vs. 40.9% in 22/23), a record for the period, indicating millers are focusing as much as they can on sugar production. With an ATR of 124.6kg/tonne (vs.125.8kg/t in 22/23), sugar production totalled 2.5mmt, 50% higher YoY. Since the start of the season, the C/S has produced 4.1mmt of sugar, 1.4mmt higher than the past season. We should also see strong results in the Second Half of May, given the dry weather in the C/S cane belt. The Brazilian government took advantage of the low oil prices and stronger BRL values over the past weeks to announce a new mechanism to control gasoline prices. The announcement caused gasoline price to fall sharply - by almost 10% - directly impacting ethanol prices. Despite the announcement, at present the price cut reflects only the lower values of the markets that dictate the gasoline price in Brazil. No one really knows how this new methodology will work out during the course of the year as the government did not share its formula for the

Disclaimer: Any comments or opinions in this report are not intended to be an offer to buy or sell commodities or futures and options thereon as they merely state our views and carry no guarantee as to their accuracy. *© ED&F MAN 2023*

prices. Last week, the government unveiled a series of measures, including tax breaks and preferential loans, to help lower car prices. Retail prices could drop by 1.5-10.8% as a result, with the highest discount offered to cheap cars with the lowest emissions.

- **India:** The latest production figures from ISMA up to mid-May showed an 8% lower sugar output YoY. India's sugar production to 15th May was 32.1 MMT, 8% down from last year. On a cumulative basis, sugar production is down by -2.8 MMT compared to the same time last year, and on fortnightly basis, down by 790 kt compared to last year's same fortnight. Out of the 6.09mmt export quota & contracted, more than 5.9 MMT of sugar has been physically exported in various qualities. With the lower sugar output, we foresee tight domestic availability. Domestic sugar prices have rallied since early April and stand at around INR 34/kg in central west India, compared to end March values of INR 31.5-32/kg. The small crop and exports have reduced India's stock availability, driving a bullish sentiment which should continue for the rest of the year until the new crop hits market. As per the IMD's first stage forecast, the Southwest Monsoon over India in 2023 is likely to be 96% of the LPA (Long Period Average) with a model error of ± 5%. Last year same time, the forecast was 99% of LPA with ± 5%. Skymet a private forecaster, expects the upcoming monsoon to be 'below normal' to the tune of 94%. The southwest monsoon over Kerala is likely to be slightly delayed to 4th June with a model error of ± 4 days. Currently, summer rains are 11% above normal and around 50% of the cane area in the central west states received above normal summer rains since 1st March.

- **Asia:** Thailand has exported almost 3.5mmt sugar during Jan-Apr'23, some 9% higher YoY. China's raws import should be close to 3.5mmt in 2023 as the domestic market failed to reach a reasonable level, if not breakeven, for Chinese refineries to utilize the OOQ license. For China's whites demand, considering the strict border control against smuggling, the whites arbitrage window is with liquid and blends imported from ASEAN origin at zero tariff. However, with the Thai crop reduction and high futures price, it is costly to expand the trade flow for the time being. Demand for whites is suffering London futures trading above $700/MT in the past few weeks. Although Philippines just announced a new import order of 150k sugar, we see refined demand lost in other Asian countries with weak appetite for forward contracts. In general, Asian demand could be further compromised if the linkage between domestic prices and the international market weakens. Looking to next year, weather remains concerning as rainfall in Thailand is 70% lower YoY. If the rains continue to disappoint, we may even see the 23/24 crop falling to a 70-75mmt range of cane production.

- **Centrals:** According to Asazgua, the Guatemalan harvest is over, with an estimated final sugar production of 2.76mmt, basically the same volume of the past season. El Salvador's crop is also over, reaching 815kt of sugar, about 30kt less than the past season. Preliminary estimates for Costa Rica shows a production drop of 20% in the country. All in all, Centrals' production was about 5% lower than last year, when 5.1mmt of sugar were produced. The region has also commercialized much of its production, leaving only few quantities to be exported until the start of the next season.

- **US:** The latest WASDE report presented the first view for the 23/24 season for USA and Mexico. According to the USDA, US sugar production is projected at 8.4mmt RV, marginally lower than the current crop. TRQ imports (which still do not present whites quotas which will only be announced in June) are projected at 1.26mmt RV, the minimum levels consistent with the WTO and FTA bindings. As usual, the USDA starts off showing a big number for the Mexican quota, at 1.4mmt RV. But at this stage, this number is largely symbolic. If were to use this number though, the US stock to use would reach 11.9%, below the target of 13.5%. For the current crop (22/23) the WASDE showed a small increase in US consumption of 68kt RV to 11.5mmt RV. At the same time, it the Mexican quota was reduced by 59kt to 1061kt as the USDA claims that Mexico is expected to produce less low polarity sugar than previously estimated, and refined exports are reduced to assure that no more than 30% of the total is refined.

Disclaimer: Any comments or opinions in this report are not intended to be an offer to buy or sell commodities or futures and options thereon as they merely state our views and carry no guarantee as to their accuracy. *© ED&F MAN 2023*

- **Mexico:** Mexico's sugar balance as of April shows ending stocks at 2.5mmt, 10% lower YoY, according to Conadesuca. This is due to the strong drop in production during the current season. Since the start of the crop, (Oct/22), domestic sales reached 2.4mmt, only 1% lower than the previous season. According to Conadesuca, as of May 20th, sugar production totalled 5.15mmt, almost 800kt lower YoY. Out of the 48 mills, only 12 mills are still crushing. The USDA has reduced the Mexican production estimate from 5560kt to 5385kt for the current crop. For the next season, the USDA projects a crop of 5.9mmt.

- **EU/UK:** The first MARS reports presenting beet yields for the 23/24 crop were mixed, with Italy and Spain seeing lower yields than normal due to dryness in the past two months. On the other hand, big producers like France, Germany and Poland ended being very wet, delaying plantings. Even so, MARS indicated that the Northern producers will benefit from the rains, achieving higher yields than last year. It's a little too early to use their figures for our projection, but if we did, it would considerably increase our sugar output - by more than 500kt. Eurostat reported larger imports in the first quarter compared with 2023, which indicates EU/UK stocks are higher than last year, something the market was not expecting.

- **CIS:** Ukraine's beet sowing is close to 205k ha (as of May 11th) confirming expectations of a crop area about 20k-30k ha higher than last season. At the same time, the EU announced that it reached an agreement with five eastern states (Poland, Hungary, Slovakia, Bulgaria and Romania) which would allow them to block some imports from Ukraine, excluding sugar. At the same time, EU governments agreed to extend by a year the suspension of duties and quotas on imports from Ukraine to help its economy during the war with Russia. As a result, Ukrainian sugar exports to EU should remain high. Between Oct to Mar, more than 300kt of refined sugar were exported.

Focus – China

With Yunnan province ending its cane crushing on 11 May, China's 2022/23 sugar crop closed at 9mmt, down 600k from the previous year. The current crop firstly came in with an optimistic outlook to reach 10.3mmt on account of higher acreage, especially beet, and better agricultural yields following improved field management in Guangxi. However, as the season went on agricultural yields in the beet area started to come in lower than expected (despite better sugar yields). Furthermore, sugarcane availability in Guangxi started to decline from February, which flagged the downside of 22/23 crop. The decreasing crushing pace in March, along with earlier than expected mill closures in April, suggested that the market underestimated the impact of dryness in Guangxi during Aug/Sep'22 which became critical even for a late stage of cane development. Eventually we lost 900k sugar from the initial estimate because of the crop reduction in Guangxi.

Figure 3: Raws import (shipment basis)

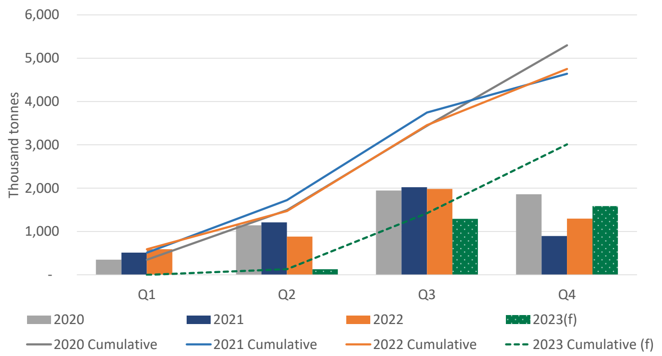
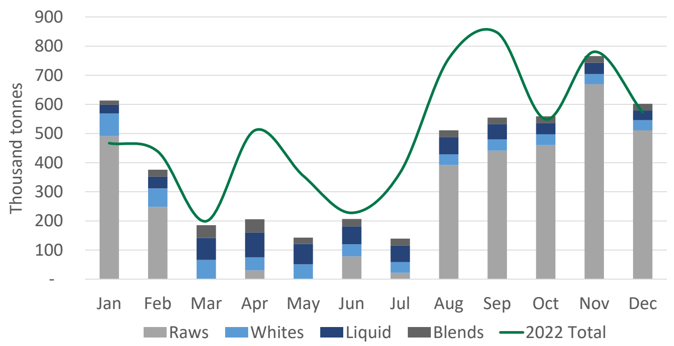


Figure 4: Monthly sugar import (arrival basis)



Source: China customs and ED&F Man Commodity Research

Disclaimer: Any comments or opinions in this report are not intended to be an offer to buy or sell commodities or futures and options thereon as they merely state our views and carry no guarantee as to their accuracy.
© ED&F MAN 2023

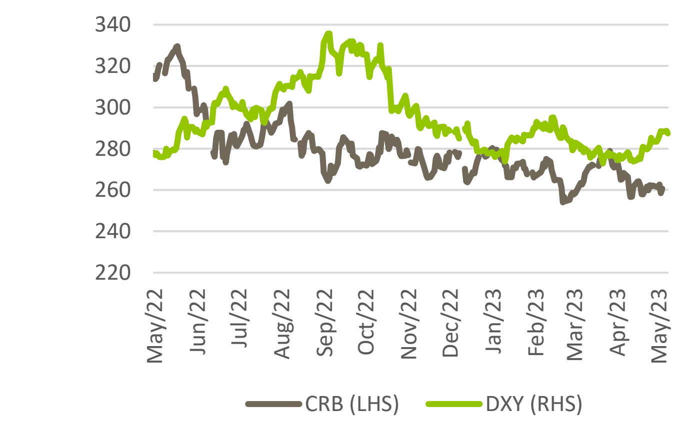
China faces a supply/demand deficit close to 6.8mmt in 2022. However, it seems like China will not have enough imports to fill the gap. As the import parity for out-of-quota (OOQ) raws at 50% tariff was negative for 15 months and trapped in a range of -$200/MT to -$70/MT since the beginning of this year, refineries have not been buying at peak prices. Even with in-quota import at 15% tariff, we see zero offtake in the first four months, compared to 500k lineups in 2022. As such, we expect stocks to be drawn down, in the absence of large bulk raw imports. Recently, container shipments have helped ease the supply tightness, with 250kt of sugar having arrived during Jan-Apr'23, 16% higher than last year. This includes the regular whites trade flow and 20kt of Pakistani LQW sugar exports to China. Additionally, China imported almost 490kt of liquid sugars and blends in the same period, 135kt higher YoY. Considering the limited supply availability in the region due to Thailand's crop reduction, this trade flow, which is typically 90% Thai origin, will be difficult to maintain at such volumes in second half of the year.

We expect the ending stock by Sep'23 to fall below the 5-year average. The Chinese government has been working on the state reserves' rotation, preliminarily at 1mmt. This will relieve the immediate feedstock shortage at refineries, but delays problem to next year, when the deficit is set to be around 6.5mmt. Rainfall in the south is currently below normal, but nation-wide moisture conditions are for supportive for sugar yields to improve. We need to monitor the key months of June-August to assess our 2023/24 production forecast of 9.4mmt. If dryness persists, the 3.3mmt of OOQ raws import will be needed more than ever.

Macro

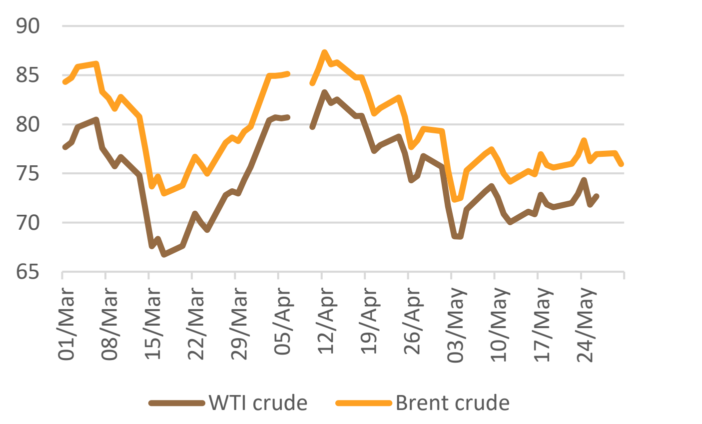
The first five months of 2023 were beset with fears of a decline in corporate margins, higher interest rates, defaults of several regional US banks, concerns about an imminent credit crunch and the US debt ceiling saga. The latter rattled markets for much of May, with risky asset classes all selling off on the back of the approaching deadline for the US debt ceiling. The dollar throughout this period strengthened, recovering to 2-month highs on safe haven buying. While a deal to avoid a US debt default has been made by President Biden and the Republican Speaker of the House, it may not be smooth sailing as it passes through congress for final ratification. Moreover, with US core inflation, personal consumption expenditure and the job market still strong, markets are having a re-think on the Fed rates outlook. There is a growing view that another 25bps rate hike may well be on the card in June - a far cry from the view only a month ago, that rates had peaked. With real yields firming again, the dollar is strengthening again, and this is putting pressure on commodities.

Figure 7: Commodities have weakened



Source: Reuters, ED&F Man Commodity Research

Figure 8: Crude oil struggles to recover



Source: Bloomberg, ED&F Man Commodity Research

Brent crude oil is set to average just over $76/bbl in May, the lowest monthly average since December 2021 and more than USD 7/bbl lower than April. Expectations of a prolonged rate-hiking cycle in key OECD economies have increased bearishness about oil among macro-led investors; while speculators have added to their short positions on the back of weaker than expected Chinese economic data. China's economic recovery has lost momentum in recent weeks after

Disclaimer: Any comments or opinions in this report are not intended to be an offer to buy or sell commodities or futures and options thereon as they merely state our views and carry no guarantee as to their accuracy. *© ED&F MAN 2023*

an initial burst in consumer activity. In April China's industrial output, retail sales and fixed investment grew at slower paces than expected, while inflation was close to zero and Chinese consumers reluctant to borrow. Copper and other industrial metals have also weakened on similar reasons, while natural gas prices have fallen with the advent of warmer spring weather in Europe and the USA. Even grain prices have reached nearly 2-year lows on the back of a large Brazilian crop and good planting progress in Europe and the USA. Further pressure came from the Black Sea grains corridor being extended for two months.

This month we also saw a revision to German Q1 GDP data, which showed that Europe's largest economy failed to avoid a winter recession after all. The rapid pace of ECB tightening has led to a sharp tightening of credit conditions in the Eurozone. On the upside however, this is leading to a slowdown in inflation rates, with Spain and German both seeing lower price increases than expected. To the extent that this leads to a more dovish ECB view on rates, we may see some weakening of the euro, which in turn will further support the dollar short term. A stronger dollar will keep the Brazilian real at bay. Inflation in Brazil is cooling, but COPOM is reluctant to lower the Selic rate from current elevated levels. As such, the longer-term outlook remains bullish for the BRL, purely on carry trade opportunities.

Upcoming Areas of Interest

- **Brazil C/S –** Crop progress has been good so far, can it continue?
- **Brazil C/S –** Ports efficiency given large sugar and grains crops
- **Brazil C/S –** Line up developments due to over-reliance on this one origin
- **Weather –** Indian monsoon evolution and impact on cane crop

Prices Tab

New York #11					**London #5**				
(cents/lb)	26-May	28-Apr	% change		*($/tonne)*	26-May	28-Apr	% change	
Jul (23)	25.37	26.35	-3.7%	↓	Aug (23)	708.5	711.6	-0.4%	↓
Oct (23)	25.14	26.01	-3.3%	↓	Oct (23)	698.1	701.7	-0.5%	↓
New York #16					**White Premium**				
(cents/lb)	26-May	28-Apr	% change		*($/tonne)*	26-May	28-Apr	% change	
Jul (23)	41.51	43.10	-3.7%	↓	Aug/Jul	149.2	130.7	14.2%	↑
Sep (23)	41.50	44.98	-7.7%	↓	Oct/Oct	143.9	128.3	12.1%	↑
Macro					**Currencies**				
Indicators	26-May	28-Apr	% change		*Against US$*	26-May	28-Apr	% change	
CRB	260.7	268.2	-2.8%	↓	Euro (EU) *	1.072	1.102	-2.7%	↓
Gold	1,946	1,990	-2.2%	↓	Pound (GB) *	1.234	1.257	-1.8%	↓
Brent Oil	76.95	79.54	-3%	↓	Real (Brazil)	4.994	4.987	-0.1%	↓
Baltic Dry	1,172	1,576	-26%	↓	Rupee (India)	82.57	81.72	-1.0%	↓
Handysize	588	663	-11%	↓	Rouble (Russia)	79.00	79.45	0.6%	↑
					(* rate is US dollars per FX)				

This report does not constitute advice and should not be treated as such. The report does not contain recommendations regarding any investment strategy, security or commodity, or an offer or solicitation to buy or sell either commodities or securities. Should you seek to rely upon any of the content of this report, you do so at your own risk. While we have taken reasonable steps to ensure the accuracy of the information contained in the report, we do not give any warranty or representation of any kind as to its accuracy and/or completeness. We do not accept any liability for any loss or damage arising from any inaccuracy or omission in, or the use of or reliance on, the information in this report. © ED&F MAN 2023

Disclaimer: Any comments or opinions in this report are not intended to be an offer to buy or sell commodities or futures and options thereon as they merely state our views and carry no guarantee as to their accuracy. *© ED&F MAN 2023*