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Sugar renaissance

Analysts have been very busy revising their forecasts for the 2016-17 global sugar balance to reflect bearish developments in the market. Over the past several months, some estimates for the global production/consumption deficit reached close to 10 million tonnes, but the average of recent estimates is closer to 5 million tonnes. Moreover, there's been talk of a balanced, or even surplus, market for 2017-18. That's not as far off as it seems – Brazil starts crushing the 2017-18 cane crop in April.

The most important issue was increased sugar production in Brazil. The combined effect of the bull market in sugar and the bear market in crude oil meant that profitability of crushing cane for sugar improved *vis-à-vis* ethanol production. The percentage of cane that was turned into sugar jumped to its highest level in years.

The market also reacted to an upward revision in the estimate for Chinese 2016-17 output of about 1 million tonnes, to 9.5 million tonnes. This coincided with a slowdown in Chinese imports.

We believe, however, that both of these bearish factors are temporary.

First, the OPEC agreement to limit crude output has sent oil prices to their highest level in one and a half years. There is no way of knowing if the member states will adhere to the accord. At present, with the rally in crude prices, it would seem that the market believes that OPEC is serious. As the price of crude moves higher, ethanol demand should rebound. The Brazilian 2016-17 crushing season is over, so there is no further fallout from low crude prices at the moment. The 2017-18 season does not begin until April. By that time, we expect to see sugar production revert to its normal output ratio against ethanol.

We continue to believe that the Chinese situation is a sleeping monster for the sugar market. There have been Persistent newswire headlines regarding government stock sales. Even with the uptick in output, the produc-tion/consumption deficit would be somewhere between 5 and 7 million tonnes. According to the USDA, ending stocks levels stand at no more than 2.5 million tonnes, which means if the government sold the entire inventory, there would still be a production/consumption deficit – hence, imports will be absolutely necessary.

The market closed out 2016 with a sharp bounce off the lows, and the rally continued into the new year, all of which was probably driven by a significant development in India. Traders had been working with estimates for 2016-17 Indian production that – in our opinion – did not adequately reflect the extent of the drought suffered in the key growing regions.

Until recently, estimates were running close to 24 million tonnes, down from 27 million tonnes in 2015-16. In the November 4 issue of *Focus on Futures* we said: "...we are skeptical of the national (Indian) estimate and expect to see that estimate drift lower as the crushing season advances." Now, estimates have emerged that put output at 22 million tonnes. Some mills in Maharashtra, the largest growing province, have already stopped crushing because of scarcity of cane. Normally, the crushing season extends through April.

The anomalous Brazilian output gains have been compromised by the surprise (not to us) drop in Indian estimates.

The fund long position peaked in October at 290,000 net-long contracts and has since fallen by close to 180,000 contracts. Chart 1 shows that over 100,000 con-

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tracts of open interest were shed during the 6¢-per-pound thrashing of the market and that the recent rally has not attracted much attention – yet.

The speed of the move from 18¢ to 21¢ per pound could create the appearance of an overbought situation. But as illustrated, the diagnostics show that there is ample buying power on the sidelines.

Remain long March 22 call options. For new positions, buy October 24 calls, presently trading at about 50 ticks. *[Sholom Sanik, January 6, 2017]*

Chart 1 – March sugar (bar), Open interest (line)

Courtesy Reuters

COPPER

The bull charges as Chilean output dwindles

Back in November, copper prices spiked to a one-and-a-half-year peak (Chart 2). After consolidating those gains, the bull run is back on track, challenging those highs. Unfazed by a soaring US dollar, traders are focusing on improving Chinese data and the possibility of stronger US industrial demand as a new administration takes charge of the White House. Campaign promises of infrastructure development and a manufacturing revival should stir US demand for copper and other industrial materials.

In checking the diagnostics of the copper market, we begin with an *apparent* bearish indicator. Combined inventories in the three exchange warehouse systems – LME, Shanghai, and COMEX – have been rising to just shy of mid-2015 levels. However, with open interest close to historic highs, much of the copper in the warehouses (Chart 3) has been hedged and is therefore not readily available to be moved directly for use into industrial applications.

The Chinese import bubble has been deflated, but by the same token, has not burst. In 2016, after an extraordinary buying binge that included a monthly record of over 500,000 tonnes imported in March, foreign purchases declined for four consecutive months. Since August, monthly purchases have steadied at a monthly average of about 250,000 tonnes (Chart 4). In November, the most recent month for which statistics are available, imports hit their highest level since June.

Much depends on the future of Chinese monetary stimulus and on the ability of the US president-elect to follow through on ambitious economic programs – which include a proposed $1 trillion infrastructure program. The underpinnings of increased industrial demand are – if not a certainty – definitely a possibility.

The International Copper Study Group (ICSG) estimates that global copper mine production rose by 6% during the first three quarters of 2016, mainly because of fresh capacity that came on line in Peru. That, however, does not tell the whole story. Chile is the world's largest producing nation by far (Chart 5), and ultimately, output trends in Chile will be the swing factor for global mine output.

Throughout 2016, estimates for Chilean mine output fell. The original forecast was for production to be flat with 2015.

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As the year wore on, though, problems such as weather, labor issues, and declining ore grades, which have plagued the industry for years now, have persisted. Up-to-date monthly data show that through the end of November, average monthly output is down 4.2% from 2015. Analysts are now forecasting an output decline of 4.7%.

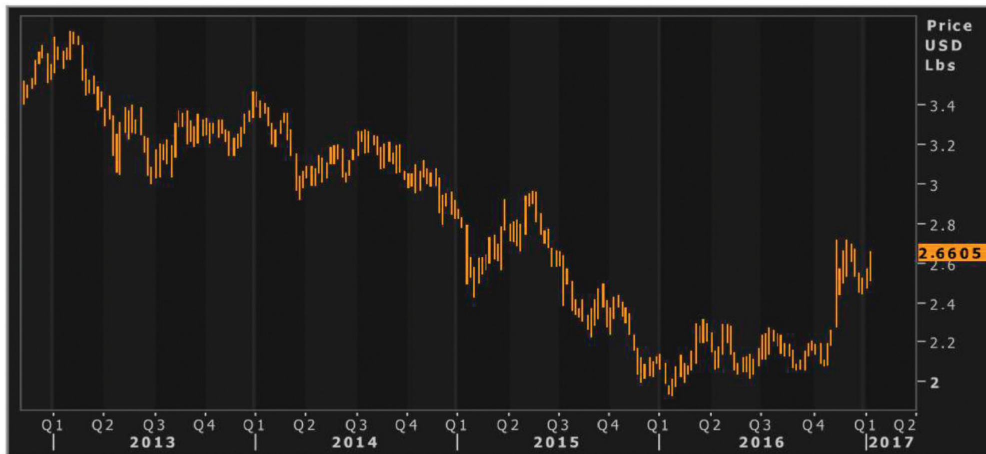
As has been the custom, the outlook for the coming year is optimistic. Some forecasts for 2017 call for a recovery, with an increase in mine production of 5.5% over 2016. We're not quite sure what this is based on. The reality is that Chilean mine output has been declining moderately since 2013, and then this year, as illustrated, the downward trend accelerated. Prices would need to continue higher to motivate an increase in supply.

Of course, Chinese demand is crucial for a viable bullish case. For the moment, while average monthly imports are below the levels we saw over the past two years, they have stabilized. The first statistic released in the New Year put China's manufacturing PMI at 51.9, its highest level since early 2013. So the foundation for rejuvenated imports is in place.

ICSG's most recent report shows that over the first three quarters of 2016, the global supply/demand balance for refined copper stood at an 84,000-tonne deficit, compared with a deficit of 24,000 tonnes for the same period in 2015.

We were – embarrassingly – stopped out of our long position way down at $2.10 per pound. Should you have been so fortunate as to have maintained a long position, continue to do so. Raise stops to $2.45 basis the nearest trading month, close only. *[By Sholom Sanik, January 13, 2017]*

Chart 2 – COMEX copper, weekly nearest contract



Courtesy Reuters

Chart 3 – Combined LME, COMEX, and Shanghai warehouse stocks

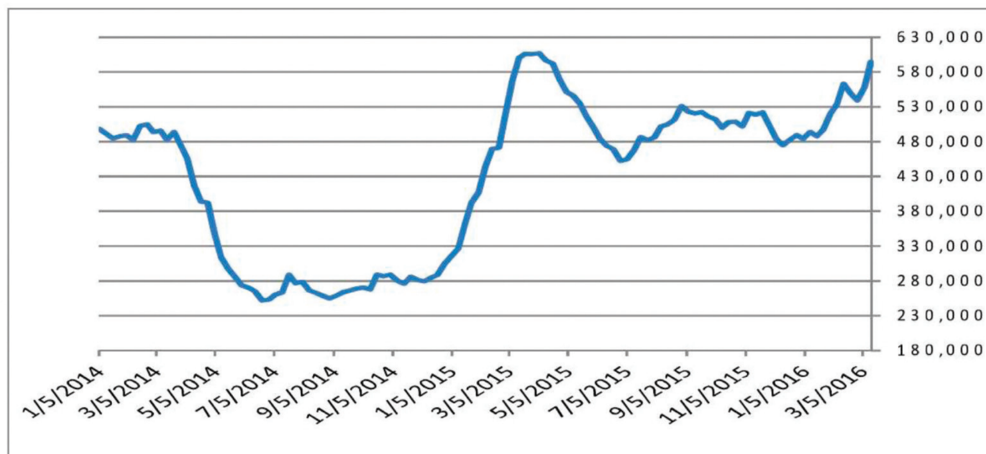


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Chart 4 – Chinese copper imports

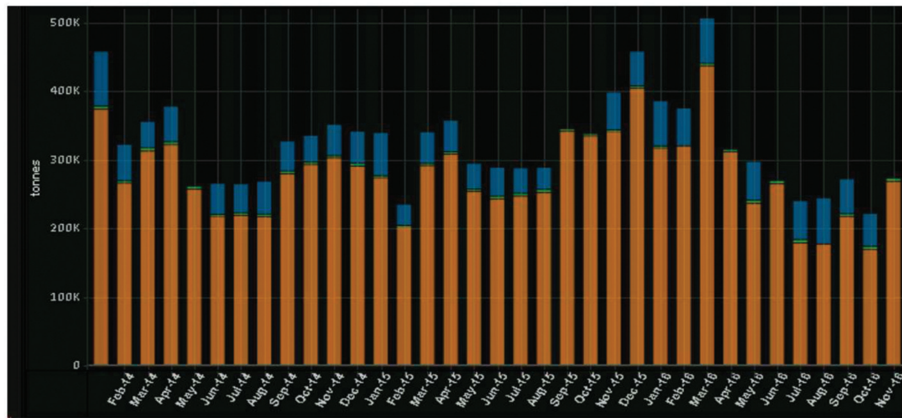
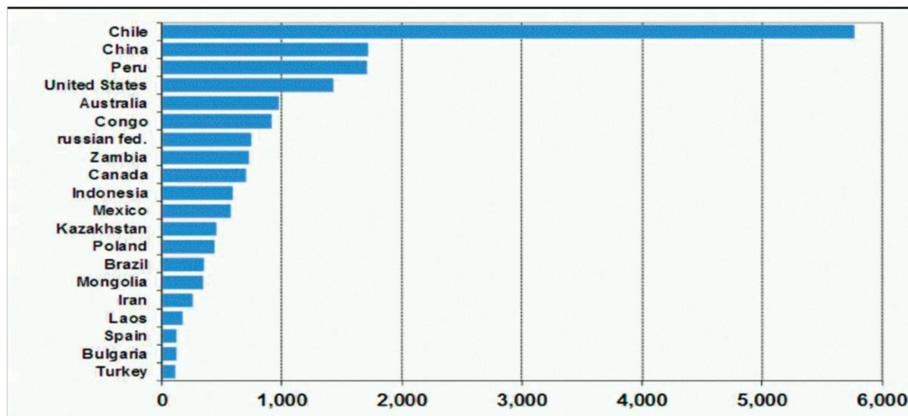


Chart 5 – Copper mine production by country (1,000 metric tonnes)



CORN

Bumper corn crops vs. demand

Corn prices have been in a rather boring trading range since the US harvest began this past fall. At present, the market is perched near the high of that range (Chart 6).

The January USDA crop report offered a mostly neutral view. Planted area for the harvested crop was lowered by 500,000 acres. In addition, the bushel-per-acre (bpa) yield was revised down, to 174.6 bpa from 175.3 bpa. Between the two, the 2016-17 crop estimate falls by 78 million bushels (1.97 million tonnes), to 15.148 billion bushels (384.78 million tonnes). That's still a record by far. Consumption data, for feed and industrial use, were mostly unchanged from the December estimate.

US ending stocks fell a notch from the December estimate of 16.4% of usage, to 16.14%, but again, it will still be the largest carryout since the 2005-06 marketing year.

Aside from these revisions, there were only minor tweaks for all other producing and importing nations. Global ending stocks were down just a tad from the December estimate, at 21.5% of consumption.

There are two issues that can move the market in the coming months: demand and South American weather.

Analysts are trying to make sense of the explosive jump in US exports. At 36 million tonnes, export commitments are 77% ahead of last year at this time. The USDA forecast for the 2016-17 marketing year for sales of 56.5 million tonnes would be an increase of just 17% over last year. Shipments stand at 17 million tonnes, which is also well above the pace of recent seasons for this time of year.

The torrid pace of foreign purchases may not be sustainable, particularly once South America enters the market with its new crops. But when penciling in a rough calculation for average weekly sales for the balance of the season based on the volumes seen in recent years, we still find the USDA estimate to be on the low side.

That brings us to South American producers. Brazil had an off year, falling from 85 million tonnes in 2014-15 to 67 million tonnes in 2015-16. This year's crop is estimated to bounce back to a record 86.5 million tonnes.

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The full effects of the elimination of the Argentinean export tax is expected to lift Argentinean production to an entirely new plateau of 36.5 million tonnes. That compares with 2015-16 record output of 29 million tonnes.

Thus far, there have been some weather issues, but broadly speaking, the Brazilian and Argentinean estimates look attainable if the weather holds up. While that seems to be the conventional wisdom for the moment, we believe that the market wants proof that Argentina can take the leap into new territory that represents a 25% increase in output.

To the small extent that the USDA's revision to the harvested US crop was bullish news, it was canceled out by a higher-than-expected quarterly stocks report. Overall, the crop report was neutral. The market's push towards the recent highs is therefore a bit enigmatic.

We believe that bumper crops in South America – if achieved – do not alter the landscape materially. Although all major exporting countries – which includes the US, Brazil, Argentina, and the Ukraine – will have higher output than in 2015-16, market participants are obviously concerned about strong demand. Even after accounting for higher production, global ending stocks for 2016-17 are actually estimated to fall to 21.5% of consumption from 21.8% in 2015-16. While we have not seen the global carryout at these levels in 15 years, any glitch in South American weather and/or if weekly US exports continue to average 1 million tonnes, the global balance sheet could be redrawn in a hurry.

As illustrated, there is no current compelling case to be overly bullish on corn prices. But why fight with a winner? In stepping out of the fundamental analysis arena for a moment, we find a chart that looks like – in technical analysis parlance – "it wants to go higher."

We are long as per our September 28 recommendation. Remain long and raise protective sell stops from $3.10 per bushel, basis March, to $3.40, close only.

[By Sholom Sanik, January 18, 2017]

Chart 6 – March corn

Courtesy Reuters

SOYBEANS

Argentinean weather ignites soybean prices

Soybean prices have touched six-month highs (Chart 7). The January USDA crop report contained two significant revisions, one bullish and one bearish, which by and large canceled each other out.

For the US, the estimate for 2016-17 planted area was decreased by 300,000 acres, bringing total harvested area down to 82.7 million acres. The bushel-per-acre (bpa) yield was lowered by 0.4 bpa, to 52.1 bpa. These revisions decreased the crop estimate by 54 million bushels (1.48 million tonnes), to 4.307 billion bushels (117.21 million tonnes).

Viewed in isolation, that could be a worrisome development. When taken in perspective, however, it was a non-event. It is still a record crop by far – 10% larger than the 2014-15 and 2015-16 crops. Furthermore, although the estimate for ending stocks fell by 60 million bushels (1.64 million tonnes), to 420 million bushels (11.44 million tonnes), or to 10.2% of usage, down from the December estimate of 11.6%, when compared with the 4.5% average of the previous five years, US supplies would be ample.

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For South America, the Argentinean estimate was left unchanged from December at 57 million tonnes. The forecast for Brazilian output was increased by 2 million tonnes, to a record 104 million tonnes, even higher than the average of analysts' guesstimates of 102.4 million tonnes.

Weather in Brazil has been favorable, and some private forecasts for Brazil put the crop even higher than the USDA's upwardly revised estimate, at 106 million tonnes.

The weather in Argentina, however, has not been nearly as cooperative and explains why the market has been rallying, despite the seemingly bearish supply-side fundamentals implied by the USDA crop report.

There's been too much rain in the northern growing regions and too little in the south. Some analysts are saying that Argentinean output could fall below 50 million tonnes! That compares with the USDA's 57-million-tonne estimate.

In a worst-case scenario, even if Brazilian output were to meet the most optimistic forecasts, it would be overshadowed by a 7-million-tonne drop in Argentinean output. So while bears may have considered the USDA crop report harmless, these recent weather developments may rewrite the script.

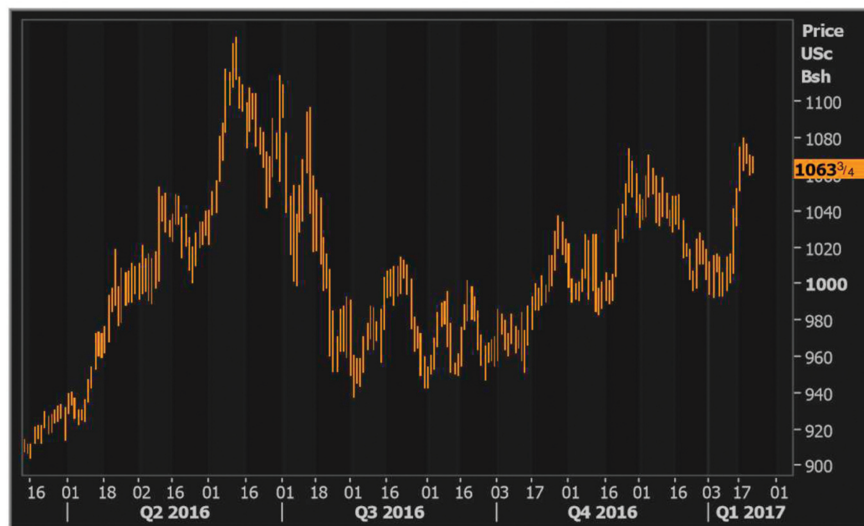
Aside from South American weather, the other variable is demand. US export commitments have reached 49.3 million tonnes, 23.5% higher than the 39.9 million tonnes recorded at this time last year. The USDA estimate for 2016-17 is 55.79 million tonnes, only 5.9% above last year. True, 16 million tonnes of sales were carried over from outstanding and unshipped sales from 2015-16, but shipments are also well above last year at this time – by 6 million tonnes. So it's a good bet that the USDA will have to raise the export estimate if new sales continue at the current clip.

Global consumption is estimated at a record high 330 million tonnes. According to the USDA January balance sheet, ending stocks would be 25.1% of usage. But if the Argentinean situation does not improve and the gloomy output forecasts are realized, some rough arithmetic would indicate that those inventories will be drawn down closer to 23.5%, which would be the lowest carryout since 2013-14. Still not a devastating figure, but it effectively means that the fantastic crops in the US and Brazil did little to restock global inventories.

Finally, as we have frequently pointed out, it pays to remember that the Chinese grow only a fraction of their soybean needs – very much unlike corn and wheat for which they are self sufficient. Demand is expected to grow to 86 million tonnes, up from 83.23 million tonnes in 2015-16. So the Chinese remain reliable customers.

Remain long March soybeans as per our November 15 recommendation. Raise stops from $9.40 per bushel to $9.90, close only. *[By Sholom Sanik, January 23, 2017]*

Chart 7 – March soybeans



Courtesy Reuters

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