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Strong demand for soybeans absorbs record South American crops – for now

In the June supply/demand situation report, the USDA raised its estimate for 2000-01 Brazilian soybean production yet again to 37.5 million tonnes, 1 million tonnes higher than last month's estimate. Although the US is still the world's largest producer and exporter, Brazil and Argentina are closing the gap. Only five years ago 49% of all soybeans produced in the world were grown in the US compared with 29% for Brazil and Argentina. With this season's crops, the difference in market share has narrowed to 44% and 37%, respectively. Together, Brazilian and Argentinean 2000-01 output grew an extraordinary 8.1 million tonnes, or 14.6% over last year.

Despite ample supplies, soybean complex prices have been in a steady uptrend this spring, with July beans rising about 50¢ per bushel since late April. A strong demand side has absorbed much of the new supply and has allowed the market to overcome the formidable obstacle of the bumper crops in South America. Chinese purchases and feedlot operators in Europe and elsewhere scrambling to replace banned animal meals have been the source of strong export activity.

Growth in world trade ground to a halt during the Asian crisis in the late 1990s, but has exploded in the past couple of seasons. In 1999-00, global exports grew by 7.53 million tonnes, or 19.4%, and rose again in 2000-01 by 4.69 million tonnes, or 10%. This has kept inventories from building up. World 2000-01 ending stocks held steady at 17% of consumption, about the same level as recent years, even though production rose a whopping 12.72 million tonnes, or 7.9%.

Brazil and Argentina have taken a big bite out of the export market. Together, the two countries' exports jumped 4 million tonnes this year. Although the US export market did not experience that kind of growth this year, it did manage to keep pace with last year's record exports. The USDA raised its estimate for US exports to 27.08 million tonnes, a slight increase from last month and just over 500,000 tonnes more than last year.

Early forecasts for the demand side of the upcoming 2001-02 season were constructive. Revisions to 2000-01 US data reduced the carryover to 270 million bushels, the smallest since 1997-98 and contributed – in part – to a 60-million-bushel downward revision to 2001-02 ending stocks. The 2000-01 revisions, an increase in forecasts of 20 million bushels for the crush and 15 million bushels for exports, combined to reduce 2001-02 ending stocks to 440 million bushels, down from last month's estimate of 500 million bushels.

The demand side has carried this rally. The supply side, however, could pressure prices. Besides the huge South American crops that are already in, we have to start looking at the new US crop. Of all major US crops, soybeans require the least natural-gas-based fertilizer. Soaring natural gas prices prompted US farmers to devote more acreage to beans than they normally would have. While gas prices have come down significantly, planting intentions have not. Corn and wheat acreage will be about 3% below last year, while bean acreage will be about 3% above last year.

In this issue

Unless otherwise indicated, all articles have been written by Sholom Sanik (E-mail: ssanik@friedberg.com).

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Just today, Sparks Commodities released its estimate of US soybean acreage at 77.3 million acres compared with the USDA's estimate of 76.7 million acres. Using the USDA's yield-per-acre estimate of 39.5 million bushels, the Sparks estimate would tack 25 million bushels back on to 2001-02 ending stocks.

Open interest has grown by close to 30,000 contracts during this rally. Small speculators have built up a robust long position, as they have in soybean meal. From a historical perspective, however, the open interest level is not overwhelming, which means that a minor correction could quickly release whatever excess baggage the market is carrying.

Although we've run US supplies down to 270 million bushels, the market may be ahead of itself, because of the availability of South American supplies. The bullish argument is that demand has surprised. The animal meal affair has added at least a few million tonnes of new and permanent consumption. For the moment, we are skeptical about the market's ability to hold this rally. Although exports are running ahead of last year at this time, recent new commitments have been rather limp. With a bias to the bullish side, we are on the sideline and watching carefully. *[June 15, 2001]*

STRATEGY: *Stay tuned.*

Chart 1 – August Soybeans

WHEAT

Consistently improving fundamentals, but prices continue to erode

Excess supply of an asset will depress its price, whether it's a security, an apartment building, or in our case, a commodity. Weak prices, in turn, will discourage the overproduction that caused the surpluses in the first place and ultimately bring the market back into balance, with price stability.

The wheat market has been through at least some of this cycle in terms of weak prices but can't seem to get the price stability part right. The reason is quite simple: Generous government subsidies paid to farmers in the major exporting countries such as the US, the EU, and Canada have become even more generous and have allowed farmers to continue planting crops that would otherwise not turn a profit for them. Consider that in 2000, US farmers received $23 billion dollars in direct government assistance, a figure that has roughly tripled since the mid-1990s. As such, low prices have not served as a deterrent to planting.

Over the past few years, burdensome US ending stocks have been the single biggest factor in maintaining the bear market in wheat. The 1997-98 and 1998-99 seasons saw bumper crops, but domestic consumption and exports were relatively flat. The imbalance between production and consumption during this period resulted in ending stocks that ballooned from 12 million tonnes, or 19% of consumption at the end of the 1996-97 season, to nearly 25 million tonnes, or about 40% of consumption at the end of 1999-00.

Although 2000-01 ending stocks are still quite high at 2 million tonnes, or 35% of consumption, we feel that a turnaround has begun. The smallest winter wheat acreage planted in decades and significant crop losses will combine to yield a total 2001-02 crop of just under 53 million tonnes, 12.5% smaller than the 2000-01 crop. Back in the fall, farmers certainly intended to plant to their heart's content – unfazed by low prices, courtesy of Uncle Sam – but inclement weather thwarted those plans. According to early USDA forecasts, ending stocks will drop sharply, to 16 million tonnes, or 25% of consumption, much closer to the kind of ending stocks we saw in the glory days of the mid 1990s, when wheat skyrocketed to $7 per bushel. Mother nature took care of the overproduction issues that were precipitated by subsidies.

Turning to the global scene, when the USDA shocked the market with its 40-million-tonne hike of Chinese ending stocks in May, it seemed that a move to uncharted bear market territory was inevitable. Indeed, we've drifted lower since. Despite the bleak outlook for prices, we maintain that the trend of lower output stacked up against growing consumption cannot be ignored.

Among major importers, the production side continues to erode. The Canadian Wheat Board issued a report yesterday that chops the 2001-02 Western Canadian output by 1.3 million tonnes from the previous season's crop. Its Australian counterpart forecasts the Aussie wheat crop will be close to 2 million tonnes lower than the USDA's June estimate. The EU will produce 7 million tonnes less than last year. In this group, only Argentina will harvest a larger crop than the previous season, with an increase of 1.5 million tonnes.

The USDA lowered the world crop by 3 million tonnes from its May report and raised consumption by just over 2 million tonnes. These revisions are significant in terms of the first glance we've had at the 2001-02 season after the Chinese ending stocks were revised. Ending stocks for 2001-02 are forecast at 132 million tonnes, or 22.2% of consumption, compared with a carryover of 139.6 million tonnes, or 23.6% of consumption in the May 10 report. Admittedly, this looks a lot different – fictitious as it may have been – than ending stocks that were running as low as 18% of consumption before the Chinese revision, but it is a clear indication that the fundamentals continue to tighten.

We are now entering the fourth year of shrinking output – a period in which consumption continued to grow each year. The problems that have plagued the wheat market, however, persist. The primary issue is continued strength in the US dollar, which has kept the export market quiet. Still, we believe that this market's weakness has as much to do with an ever-increasing short position held by commodity funds as it does with weak export sales.

Contract lows often begat more contract lows, so we will stay clear for now, but we continue to monitor the situation. *[June 20, 2001]*

STRATEGY: *Stay tuned.*

Chart 2 – July Wheat

Chart courtesy of REUTERS

COCOA

Has cocoa run out of bull?

The cocoa market has shed about half of the spectacular rally we saw earlier this year. The perception among participants is that the bull run is over. Have the issues that allowed cocoa to almost double in price in a 10-week period disappeared completely?

There were two primary factors – encompassing both the supply and demand sides – that sparked the strength in prices: a 17% drop in the 2000-01 Ivorian crop and an 8% growth rate in grindings in the 1999-00 season.

Turning to consumption first, E.D.&F Man has maintained very conservative grinding projections for the new crop year, which began with the fourth quarter 2000. In its latest report (May 10), it revised them slightly downwards from its previous estimate, to 2.937 million tonnes, about unchanged from the previous season. This is *the* consumption figure that the market has been working with.

In the absence of a full set of data from the various chocolate manufacturers' associations that provide grinding information, this E.D.&F Man statistic is responsible, in large part, for the market's recent weakness. Actual grinding results, however, have been stronger in the last quarter 2000 and the first quarter 2001 than anyone has expected. For example, the first quarter 2001 US and pan-European grind were up about 3% year-over-year, while the German grind was up 8%.

While we have no way of predicting what the second quarter 2001 grind will come in at, those statistics – which will start appearing within a week or so – are of great significance in this directionless market. We submit that if the numbers surprise, as they have in the past two quarters, the whole complexion of the market may change.

If, for example, after we get a look at the second quarter numbers, the 2000-01 grind looks to be growing at a rate of 3% rather than the 0% rate currently forecast by E.D.&F Man, the production/consumption deficit would jump from the current estimate of 204,000 tonnes to just under 300,000 tonnes. Stocks as a percentage of consumption would drop from an overwhelming 40% to a bit more tame 37%.

On the production front, analysts have been focusing on favorable weather in West Africa, which should allow mid-crop yields to be on the high side of forecasts. Even in the best-case scenario, this would shrink the deficit by 10,000 to 15,000 tonnes, which pales in comparison with the increase in the deficit of 90,000 tonnes that would result from our consumption model above.

The market is also operating under the assumption that the situation in the Ivory Coast will stabilize for the 2001-02 season. Although it is extremely early, there was a forecast last week for the Ivorian main crop to bounce back by 10% next season, to 1.1 million tonnes.

The trouble with making such forecasts, however, is that there is no indication the problems in that country are gone. While analysts point to the excellent moisture levels that are vital to the early stages of crop development, they are perhaps ignoring other matters. The disappearance of the marketing board, which discouraged farmers from investing in their cocoa farms, is still an issue. There are efforts underway to establish a new version that would allow farmers to sell their beans in an organized fashion, but aside from much haggling among the parties, nothing has happened yet.

The unstable political climate is also a key issue, because the hordes of migrant workers that worked the plantations have been leaving the country *en masse*. This problem was a major contributor to the sharp drop in output in 2000-01, and again, there is no evidence that the labor shortage has been alleviated.

For many years, we talked about a peak in the Ivorian crop. Until there is a more complete picture of the 2001-02 crop, we will not know whether this past season's smaller crop was an anomaly or whether a trend to smaller crops has begun. The Man grind forecast has to be substantiated with the coming grind statistics.

In any case, we believe that the market should not return to its 2000 lows. We view this 50% correction as just that. For a market that for years was characterized by its huge carrying charges, it is quite amazing that the September/December New York spread (Chart 3) has retained a small backwardation, even through the recent weakness. Keep an eye out for clarifications of the uncertainties raised above with a bias to the bull side. This bull is not dead. *[June 29, 2001]*

CURRENT STRATEGY: *Buy September cocoa as per Flash Update of July 2. Place initial stops at 904, close only.*

Chart 3 – September/December Cocoa Spread

Chart courtesy *REUTERS*

SUGAR

A second year of deficit in the sugar market

A series of major crop disappointments in the world's major sugar exporting countries in the 2000-01 crop year spurred last year's rally in sugar prices. It was widely expected that 2001-02 output would bounce back to 1999-00 levels. There was no reason to expect recurrent inclement weather. And higher prices were expected to keep high-cost sugar producers from switching to more profitable crops. Production problems were responsible for the start of this bull market, and the outcome of this coming season's production will determine where the market goes from here.

A more complete picture of the 2001-02 season has emerged in recent weeks as Southern Hemisphere cane crops are harvested and Northern Hemisphere beet crops are in the ground. It seems that the production recovery is not turning out the way bears had anticipated.

Of major exporters, only Australia – a major supplier to the Asian market – will have a substantially better crop. A recent forecast by ABARE put 2001-02 output at 4.822 million tonnes, up slightly from a previous forecast, but 640,000 tonnes, or 15%, higher than last year's crop. But that is where the recovery ends.

In Brazil, weather damaged the 2000-01 crop enough to slash output by about 15%, to 17 million tonnes. Analysts' early estimates called for the 2001-02 crop, which is currently being harvested, to improve back to 1999-00 levels of just under 20 million tonnes. The recovery, however, has become more meager with each estimate. Just this past Friday, F.O. Licht reported that production in the Center/South region, where the vast majority of sugar is grown, is up by less than 5% over last year, which is the smallest estimate we have seen to date.

The other issue in Brazil is the government-mandated alcohol/gasoline ratio, which has already risen back to 22% after the government lowered it to 20% from 24% last year to allow more sugar to be available for export. This move tied up about 1 million tonnes.

A very wet spring in Western Europe delayed sowing. Last week, government forecasters estimated that production will fall by 1.4 million tonnes, to 15.3 million tonnes, while sugar statistician Czarnikow is calling for a 1.7 million tonne drop.

Although production may be a touch higher than last year, 2001-02 is almost certain to be a year of deficit. F.O. Licht forecast world output at 129.8 million tonnes compared with 129.24 last year. With consumption holding steady at about 133 million tonnes, we will continue to draw down inventories. Estimates for the size of the deficit range from 2.5 million tonnes to as high as 4.5 million tonnes.

Chinese buying patterns have not been clearly established, but they should be back in the market soon, looking for anywhere between 500,000 to 1 million tonnes before the end of the year. China is not known to have large inventories, and weather problems are likely to affect yields of the beet crop. China, too, was expected to have a much improved crop in 2001-02, having produced only 6.2 million tonnes in 2000-01, down about 10% from 1999-00. Published forecasts for a recovery this coming season to about 8 million tonnes are not a realistic prospect at this time.

The bearish case continues to lie almost solely with burdensome Indian carryover stocks. Weather has not been friendly to the 2001-02 crop, however, and the anticipated loss of 3 million tonnes from the previous season's 18.2 million tonne output definitely mitigates the effects of the high inventories to a large degree. In addition, Pakistan, which has a shortfall of 1 million tonnes, and would be the prime export market for India, announced on Friday that it will not lift the ban on importing sugar from India.

In conclusion, the size of the Brazilian exportable surplus will be the key to the future of this market. The recent action in the market – with prices rising 2¢ per pound since early April – seems to indicate that yields will be disappointing. *[July 2, 2001]*

CURRENT STRATEGY: *Liquidated long October sugar as per Flash Update of July 2.*

HOTLINE UPDATE

***Flash Update* – Tuesday, June 5, 2001:**
Good morning for Tuesday, June 5, 9:10 am. This is a Flash Update. We have covered our short June mini S&P position at 1269.25.

***Flash Update* – Tuesday, June 5, 2001:**
Good afternoon for Tuesday, June 5, 2:30 pm. This is a Flash Update. We have liquidated our long July wheat position at 260.50. We repeat our Flash Update of this morning, where we covered our short June mini S&P position at 1269.25.

***Flash Update* – Thursday, June 7, 2001:**
Good morning for Thursday, June 7, 9:20 am. This is a Flash Update. We have sold short September mini S&P at 1284, placing our initial stop at 1314, close only.

***Flash Update* – Thursday, June 7, 2001:**
Good afternoon for Thursday, June 7, 12:55 pm. This is a Flash Update. We have liquidated our long September T-bond position at 100-09. We repeat our Flash Update of this morning, where we sold short September mini S&P at 1284, placing our initial stop at 1314, close only.

Friday, June 8, 2001:
Good afternoon for Friday, June 8, 4:45 pm. The following is a recap of our current open position recommendations, and our latest stop levels. We are short August crude oil, with our stop revised to 28.90, and short September mini S&P, with our stop revised to 1301. All stops are close only.

***Flash Update* – Monday, June 11, 2001:**
Good morning for Monday, June 11, 10:50 am. This is a Flash Update. We have covered our short August crude oil position at 29.08.

***Flash Update* – Thursday, June 14, 2001:**
Good morning for Thursday, June 14, 9:20 am. This is a Flash Update. We have purchased September silver at 445.50, placing our initial stop at 430, close only.

Friday June 15, 2001:
Good afternoon for Friday, June 15, 4:45 pm. The following is a recap of our current open position recommendations, and our latest stop levels. We are short September mini S&P, with our stop revised to 1285, and long September silver, with our initial stop at 430. All stops are close only.

***Flash Update* – Wednesday June 20, 2001:**
Good morning for Wednesday, June 20, 10:20 am. This is a Flash Update. We have purchased October sugar at 8.89, placing our initial stop at 7.90, close only. We have also liquidated our long September silver positions at 438.50.

Friday, June 22, 2001:
Good afternoon for Friday, June 22, 4:40 pm. The following is a recap of our current open position recommendations, and our latest stop levels. We are short September mini S&P, with our stop at 1285, and long October sugar, with our initial stop at 7.90. All stops are close only.

Friday, June 22, 2001:
Good afternoon for Friday, June 29, 4:00 pm. The following is a recap of our current open position recommendations, and our latest stop levels. We are short September mini S&P, with our stop at 1285, and long October sugar, with our stop revised to 8.90. All stops are close only.

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