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Ivorian cocoa supply disappoints, but we may not need it

Although there was not sufficient time for first-quarter reporting for Covid-19 to have affected cocoa demand, the year-over-year grind indicated weakness. The EU grind rose a scant 0.9% while North America was down 4.4%. Asia was 0.5% lower. Only the Ivory Coast had a decent showing at plus 4.4%.

In terms of chocolate consumption, the week before Easter is traditionally a strong period, and what data do exist showed mixed results. One industry group reported that in the UK, sales were up 15% year-over-year, but in the US they were down 17%. Consumers in both regions were offered substantial discounts to boost sales, which may have clouded the reported results.

Product prices remain weak, leaving processors little incentive to grind more than they require to meet short-term demand. This is particularly true when the outlook for consumer confectionary demand is uncertain. The combined ratio, which measures the price of cocoa butter and powder *vis-à-vis* the London spot price, can be seen in Chart 1 to be hovering near multi-year lows.

For most of this season, port arrivals in the Ivory Coast kept pace with the previous season's record output, and it seemed that we would be looking at another record, or at least close to the 2.179 million tonnes achieved in 2018-19. The main crop fared well during the dry season. The mid-crop, which begins in March, grows during the rainy season and must have proper moisture levels to prosper. Thus far, however, the rains have been weak, and it is beginning to show up in the data.

While weather scares come and go, the situation at present could be serious, with some key regions receiving only 30% of normal rainfall along with scorching temperatures.

The most recent data show that port arrivals stand at 1.734 million tonnes, 5% below this time last year. Just one month ago arrivals trailed last year by only 1%.

Arrival statistics are not as timely out of Ghana, the world's second-largest producer. But a similar pattern is emerging. Two months ago arrivals were ahead of 2018-19 by 1%, but as of several weeks ago, they had fallen back to 1% below.

Covid-19 has not disrupted the supply chain in either the Ivory Coast or Ghana. According to a recent World Health Organization report the per-capita infection rate is much smaller than it is in developed countries. Harvesting, transport to ports, and shipment abroad have thus far not been affected in these origin countries. Lower volumes arriving at port should therefore be considered a reflection of the health of the crop.

In summary, the extent of demand loss is unknown, but is potentially large. First-quarter grind data, which have not even fully accounted for lost processing in Europe and North America due to Covid-19, were not inspiring, as illustrated above. Many beans harvested during the 2019-20 marketing year are likely to create burdensome ending stocks. On the other hand, the supply side is disappointing, which could mitigate a drop in demand.

In February, when prices were near their $2,900-per-tonne highs, we suggested establishing short positions on key reversals. Should you have been so fortunate to have identified such an opportunity, you are now short. After a steep plunge, the market has traded in narrow range since mid-March (Chart 2). Protect handsome profits with a stop at $2,500-per-tonne, basis the nearest trading month, close only.

[By Sholom Sanik, April 29, 2020]

Inside

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Chart 1 – Combined cocoa butter/powder ratio

Chart source: Reuters

Chart 2 – ICE July cocoa

Chart courtesy Reuters

SUGAR

Reevaluating the sugar market

On April 28 spot July sugar traded as low as 9.21¢ per pound, a level not seen since 2007 (Chart 3). Not so long ago – in mid-February – the sugar market was busy chalking up *bullish* statistics, taking out multi-year highs. Unlike the plunge in many commodities for which there was anticipation of demand destruction, the primary issue for sugar was the anticipation of a surge in supply. We have already discussed how Brazilian processors were likely to increase the amount of cane they will crush for sugar at the expense of ethanol (see *Focus on Futures*, March 31). Since then, however, the crushing season swung into full force, and the estimates, albeit early, are surprising, if not shocking.

One estimate puts 2020-21 Brazilian sugar output at 41 million tonnes. That compares with 29 million tonnes last year and above the record set in 2016-17. Exports are forecast to rise by 10 million tonnes over the 2019-20 marketing year, to close to 30 million tonnes. This will be achieved by a massive shift in the ethanol/sugar ratio.

For a taste of things to come, consider that typically, in the early part of the crush season, sugar content in cane is very low. For example, last year the final annual sugar ratio was 34%, while in early April it was only 23%. This year the early ratio is 39%, leading us to believe that processors are producing only enough ethanol to meet the minimum government petroleum/ethanol blend ratio. The forecast for 2020-21 calls for an increase in the sugar ratio to 48%, up from 24% last year.

There is no confidence in either the discretionary or export markets. Mainly, though, with a lockdown still in place, even the amount of ethanol used as the minimum requirement will tumble. And as the cane crop ripens later in the harvest, the tilt to sugar output should grow.

The flood of supply should not end there. In 2019-20 Asian output was affected by poor weather. After two consecutive years of producing 32 million tonnes, Indian output fell to 26 million tonnes. Thai production fell to below 8 million tonnes, from record output of 14 million tonnes in the two previous years. Asian crushing does not begin until November, but there is no reason to assume that both of these countries will not return to normal-size crop levels. A weak monsoon could change the dynamics of the market, but we will not get a sense of that until June.

A return to healthy crops in Asia and the monstrous rise in Brazil will in the space of one season flip the global market from a 9-million-tonne deficit to a surplus. Now, there is the issue of what kind of demand destruction we will be looking at. Thus far, the estimates have shown a moderate drop in consumption. One estimate forecasts a 2-million-tonne contraction in usage. Let's be liberal and say we lose 5 million tonnes. According to the loose production estimates presented above, output could grow by some 20 million tonnes. Barring weather problems, we are going to have a 2020-21 surplus.

Before Covid-19 changed the world, commodity funds had built up a formidable long position in sugar of close to 200,000 contracts. According to the most recent CFTC data, funds are now short 65,000 contracts (Chart 4). The recent spike in crude oil prices off their unsightly lows inspired short-covering, which explains the 20% rally in sugar. A timetable for a return to normal economic activity is unknown, and in any case, even as lockdowns are lifted, it will be some time before ethanol demand will return to pre-pandemic levels. Until there is any evidence to the contrary, Brazilian crushers will favor low sugar prices over building inventories of ethanol that they cannot sell.

The rally is over. Establish short positions in October sugar. Place initial buy stops at 12¢, close only.

[By Sholom Sanik, May 7, 2020]

Chart 3 – ICE weekly sugar

Chart courtesy Reuters

Chart 4 – CFTC commodity fund net position

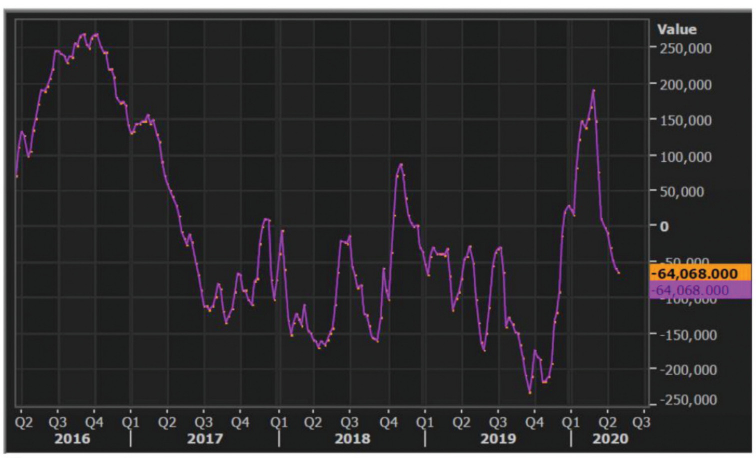

Chart courtesy Reuters

CORN

Silos will be bursting at the seams

The May USDA crop report was the first comprehensive look at the 2020-21 marketing year. For the US, the supply side presented no surprises. Massive planted area of 97 million was taken from the March 31 intentions report, so nothing new there. The record yield of 178 bushels per acre should not come as much of a shock either. The resulting crop is estimated at a record-by-far 15.995 billion bushels.

Recent years have seen farmers struggling to get crops in on time. Not this year. The most recent USDA weekly crop progress report shows that 67% of the gargantuan crop has already been planted, compared with only 28% last year at this time and a five-year average of 56%. Inasmuch as early seeding enhances yield, the USDA's estimate seems very realistic. With cooperative growing weather, it could very well be a great crop.

As expected, with people staying at home and not driving, the estimate for 2019-20 ethanol usage was revised down, by 100 million bushels, to 4.95 billion bushels. In April that figure had already been slashed to 5.05 billion bushels, down from the pre-Covid-19 estimate of 5.425 billion bushels. For 2020-21, the forecast is 5.2 billion bushels. In notes accompanying the data the USDA says that this is "…based on expectations of a rebound in U.S. motor gasoline consumption."

Ending stocks are forecast at 3.318 billion bushels, or 22.4% of consumption, the largest carryout in 33 years. That compares with 15.2% last year. This estimate was below the average of analysts' guestimates of 3.389 billion bushels and was cited as the explanation for a bullish reaction to the report.

China is largely self-sufficient in corn. Imports account for less than 3% of domestic usage. For the rest of the world, 2020-21 output is forecast to rise by 8.5%, while consumption is estimated to grow by only 4.1%. That would leave ending stocks at 15.7% of consumption, compared with 12.5% for 2019-20.

Commodity funds have built a formidable short position since early February (Chart 5). With a lower-than-expected US carryout and prices close to four-year lows (Chart 6), some short covering was to be expected. Regardless, the amount of corn that is being planted in the US and abroad is staggering. Anticipation of a return to normal consumption patterns, particularly for corn-based ethanol usage, may very well turn out to be overly optimistic.

Another area that is having bears question the wisdom of holding on to shorts is the possibility of corn acres being switched to soybeans. Indeed, that is a point being mentioned in research reports. However, with the exceptional progress on the planting front, as illustrated above, that would only prove to be a minor factor. Once the crop is planted, the only thing that could keep this market supported is stronger-than-expected demand. But the USDA has already increased estimates for all categories of US demand substantially, including feed, ethanol, and exports. We would need to top those estimates to make an appreciable dent in what can only be described as overwhelming supplies.

Maintain short positions in July corn, first recommended on February 20. Lower stops from $3.70 per bushel, to $3.45. *[By Sholom Sanik, May 13, 2020]*

Chart 5 – CFTC commodity fund net position

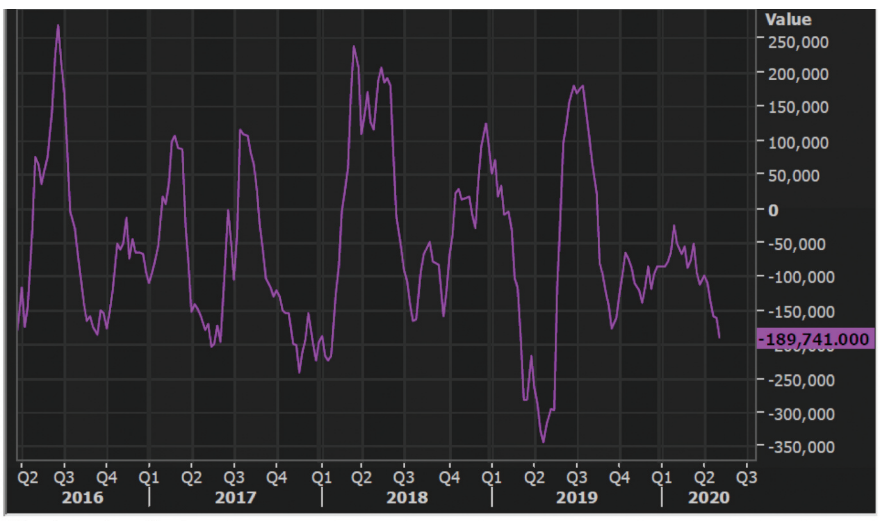

Chart courtesy Reuters

Chart 6 – CBOT weekly nearest contract

Chart courtesy Reuters

BEANS

More beans please!

In our most recent discussion on soybeans (see *Focus on Futures*, April 22) we calculated that despite what seems to be a constant stream of announced soybean sales to China, we're not likely to hit the USDA's target for US exports. That stream has continued, but it has done little in terms of eating into burdensome supplies. Indeed, in the May crop report, the USDA slashed its export estimate for the outgoing 2019-20 marketing year by 100 million bushels. Ending stocks were revised upward by the same amount, to 580 million bushels, or 14.8% of consumption. We can no longer make the assumption that we are on course to return to more "normal," pre-US/China-trade-war ending-stock levels of 7% to 8%.

For the new-crop marketing year, the USDA forecasts a full recovery in US exports to pre-trade-war status, to 2.05 billion bushels. Perhaps. Thus far, forward new-crop sales are lagging the historical norm by a wide margin. Early sales for 2020-21 stand at 2.1 billion bushels. Now that's ahead of 1.4 billion bushels sold at this time last year, which, of course, is not saying very much because the trade war was in full heat. If we take a look back at the average of the previous five years for this date, average forward sales for the upcoming marketing year were 5.1 billion bushels. So the Chinese may honor their commitments to buy US agricultural products, but there is no evidence as of yet to support the USDA's export estimate.

On the supply side, planting of the new-crop is proceeding at a rapid clip, which unlike some recent years, bodes well for an early harvest, which eliminates frost risk. As of the most recent weekly progress report, 53% of the crop has been planted, compared with last year's weather-plagued planting season when only 16% of the crop had been planted by this date. The five-year average is 38%. Barring growing-season inclement weather, the USDA's forecast for a 49.8 bushel-per-acre (bpa) yield looks achievable. The record was set in 2016-17 at 52 bpa. With the early start, the USDA estimate may even turn out to be conservative.

March 31 planting intentions were initially viewed as bullish, but only by virtue of being 1.3 million acres below the average of trader's guesstimates. At 83.5 million acres US farmers will be planting the same soybean area that they did in 2015-16 and 2016-17. That can't be wise when we're going to finish 2019-20 with a burdensome stockpile.

The situation could be exacerbated by the massive amount of corn that is slated for planting. Although corn planting is almost complete, the price advantage of planting soybeans could incentivize farmers to switch whatever they can in the latter stages of the planting season. Chart 7 shows that the soybean/corn price ratio is as high as it's been in two years. We do not believe that this will be a huge factor, but the last thing the soybean market needs is more supplies from any source.

Moreover, the US is no longer the supplier of last resort for this market. The current marketing year marks the first time Brazil produced more beans than the US. True, the US had an off year because planted area was reduced to accommodate for the trade war, but the forecast for the new-crop year estimates Brazilian output at 131 million tonnes vs. 112 million for the US. Brazilian exports for 2019-20 are estimated at a record 84 million tonnes, up from 74.6 million tonnes the previous season. US farmers must remain competitive to stay in the game, which is another bearish factor for US prices.

Remain short November soybeans, as per our April 22 recommendation (Chart 8). Lower stops from $8.90 per bushel, to $8.70, close only.

[By Sholom Sanik, May 22, 2020]

Chart 7 – Soybean/corn ratio

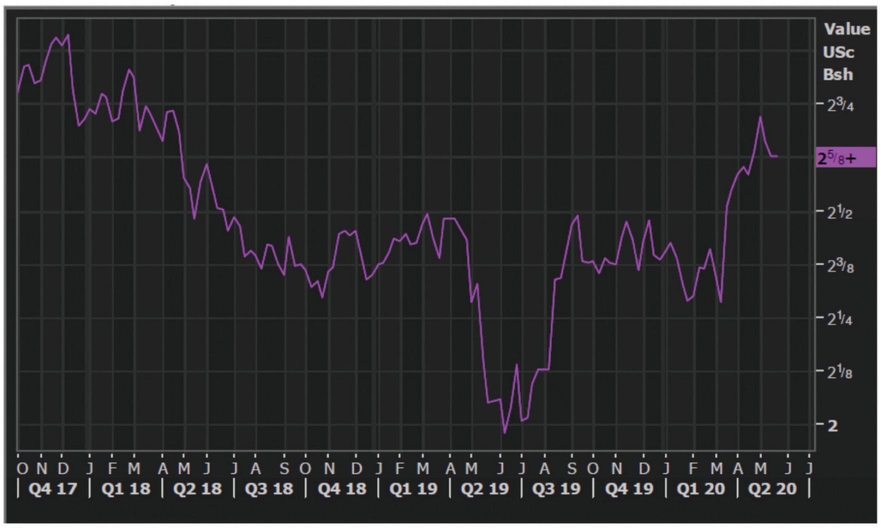

Chart courtesy Reuters

Chart 8 – CBOT November soybeans

Chart courtesy Reuters

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