Cocoa Outlook: Time for a Choco-late Bull Run?

Agri Commodity Markets Research

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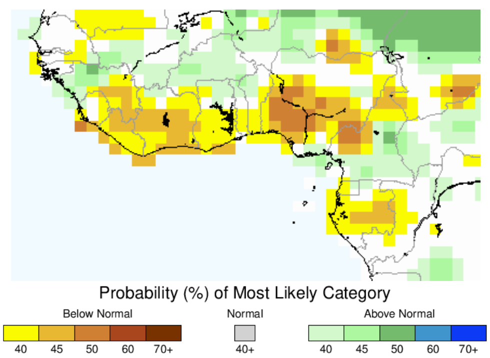
- The potential for drier-than-normal weather poses production risks in West Africa in the months ahead.
- We reduce our previous global surplus and deficit estimates on the back of weather risk and strong demand; 2020/21 is now seen with a surplus of 123,000mt and 2021/22 with a deficit of -8,000mt.
- High consumer confidence in Asia may be driving demand growth in the region, with plenty of space for a further recovery in the US and Europe.

Over the past twelve months, many agri commodity prices have risen substantially, with the S&P GSCI Agriculture Index up almost 60% YOY. Cocoa, however, appears to have been left out of the bull run, with prices in New York only up 7% YOY and flat in London. The curve for both contracts also moved from steep backwardation to contango, suggesting a change in sentiment. So why has cocoa been left out and could it be due to its own late bull run?

A Shifting Production Outlook

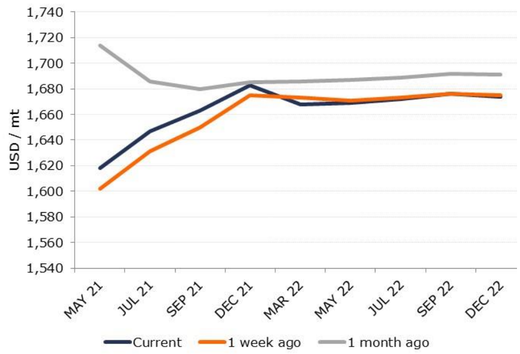
The unseasonably good weather in West Africa that boosted 2020/21 production may not continue ahead of the 2021/22 season. Recent rainfall across Ghana, parts of Côte d'Ivoire, and elsewhere in West Africa has been below average, increasing stress on trees and reducing soil moisture levels in cocoa regions. This is due to the Africa Intertropical Front being well below its mean position. Furthermore, long-range IRI forecasts suggest a higher probability of lower-than-normal rainfall continuing over the coming months, and with a neutral ENSO outlook, we may see inadequate soil moisture levels as we enter a more normal dry season toward the end of the year. The less-than-ideal weather and outlook have led us to reduce our global production estimates for 2021/22 by 60,000mt to 4,941tmt.

Figure 1: Three-month precipitation forecast, June-July-August 2021



Source: IRI, Rabobank 2021 as of 22 April 2021

Figure 2: Changes to London Cocoa Futures curve (current as of April 23,2021)

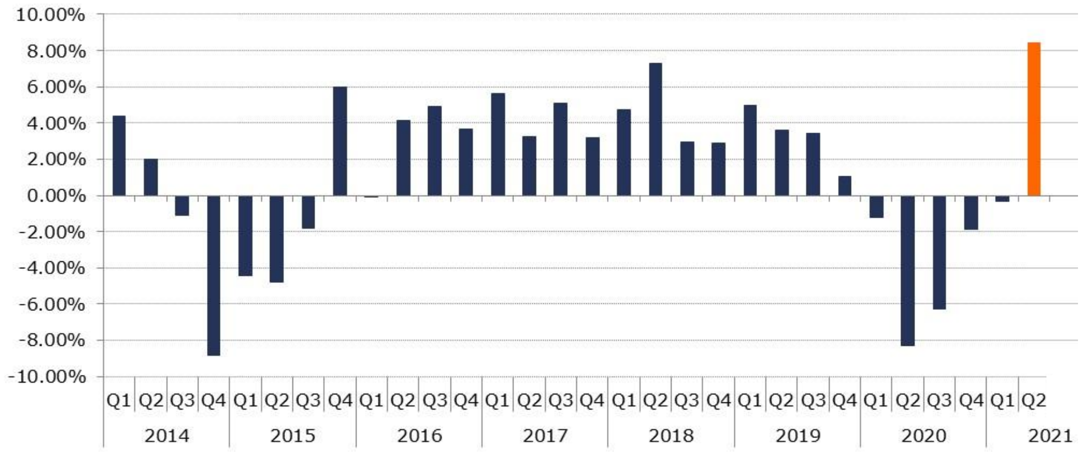


Source: Bloomberg Finance L.P., Rabobank 2021

Cocoa Demand Gaining Ground

Recent cocoa grinding figures for the three main reporting regions were positive for Q1 2021 on an aggregated level and, in our opinion, still have the capacity for further growth. Asia performed the best, with its highest reported Q1 grinding figure on record, a 3.1% increase on last year. Overall grinding figures for the three regions were only down by -0.3% YOY but continue to show a strong recovery from Covid-19 lows.

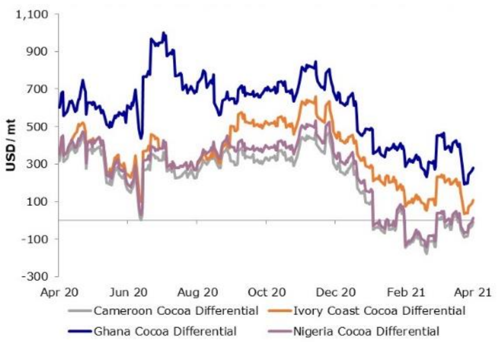
Figure 3: Quarter-on-Quarter % change in aggregated reported grind figures for Europe, Asia, and North America and Rabobank forecast, 2014-2021f



Source: NCA, ECA, CAA, Rabobank 2021

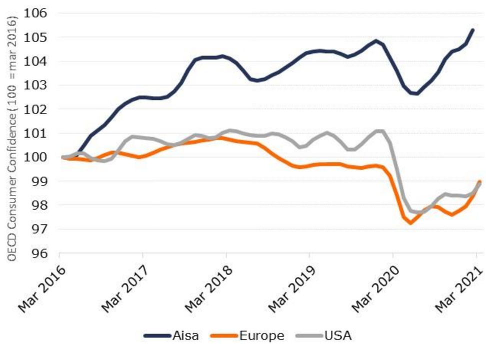
Looking ahead to next quarter, we expect good demand to continue in Asia and conservatively estimate grinding figures to at least return to 2019 levels. North America and Europe should see a continued recovery backed by strong retail sales, with levels improving substantially year-on-year but remaining marginally below 2019. Overall, we expect aggregate cocoa grinding to increase around 8.5% YOY, the largest quarterly increase since 2010. For the 2020/21 season, we increase our estimate of global cocoa demand growth to 2.2% YOY from 1.6%. We believe that much of the growth in retail will remain strong into 2022, which when coupled with improving consumer confidence and recovering out-of-home consumption should lead to solid demand growth for cocoa. In 2021/22, we expect cocoa demand to grow by 3% YOY, up from our previous estimate of 2.2%.

Figure 4: African gross cocoa differentials have declined substantially since December 2020



Source: Bloomberg Finance L.P., Rabobank 2021

Figure 5: Consumer conference above pre-pandemic levels in Asia but lagging in the US and Europe

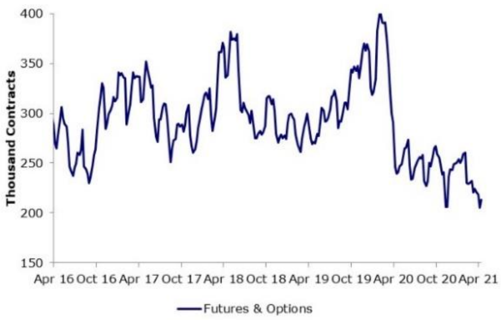


Source: OECD, Rabobank 2021

Balancing on a Tight Rope

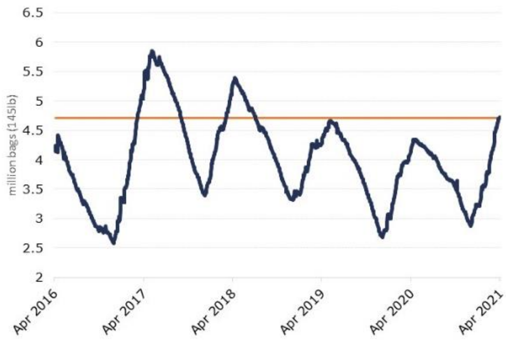
The current supply and demand balance suggests a large surplus in the market. This is backed up by increasing US merchant stocks, which are the highest since 2018, and declining differentials at origin, suggesting very good availability. Since December, reports suggest European differentials have declined as much as 60% for Nigeria and Cameroon and around 50% in the Côte d'Ivoire and 30% in Ghana. In addition to the decline in differentials, futures prices also fell around 7.5% for the period. Furthermore, the Conseil du Café-Cacao recently reduced the farmgate price in Côte d'Ivoire by 25% for the mid-crop. The decline in Côte d'Ivoire also suggests a greater flexibility on price than previously expected. The current supply situation is bearish and, coupled with uncertainties stemming from Covid-19 and the living income differential (LID), has resulted in reduced futures market participation from both speculators and commercials and reduced forward cover. ICE NY Cocoa open interest in futures and options is at around the lowest level in six years, and forward sales for the 2021/22 crop in Côte d'Ivoire and Ghana are reported to be lagging 2020/21 substantially.

Figure 6: ICE NY Cocoa open interest has declined from both Commercials and Non-Commercials



Source: CFTC, Rabobank 2021 as of April 13, 2021

Figure 7: ICE US Cocoa stocks have risen considerably to the highest level in three years



Source: ICE, Rabobank 2021 as of April 22, 2021

Looking ahead, strong consumption growth and less-than-ideal weather in West Africa in the lead up to the 2021/22 main crop could cause the 2021/22 balance to turn negative. The potential for this appears underpriced in our opinion, with demand likely continuing to steadily rise over the next 6 months and possibly over the next 12 months. Much of the increase in retail demand seen over the pandemic will likely be sticky, despite the easing of lockdowns and increasing out-of-home consumption. The net effect from this and better consumer sentiment will likely be an overall demand boost that could be present in the market for some time. The greatest risks for price increases appear in Europe, where stocks have not increased in the same way they have in the US due to the present futures arbitrage. We have changed our outlook for 2021/22 from a surplus of around 60,000mt to a deficit of 8,000mt, a much tighter market than previously thought, on potentially higher-than-expected demand and lower production.

Table 1: Surplus/deficit balance (crop year), 2015/16-2021/22f*

	15/16	16/17	17/18	18/19	19/20	20/21f	21/22f
Production	3,994	4,768	4,646	4,784	4,736	4,931	4,941
Cote d'Ivore	1,581	2,020	1,964	2,154	2,125	2,210	2,150
Ghana	778	969	905	812	800	870	870
Ecuador	232	300	287	322	328	340	360
Nigeria	200	245	250	270	250	270	280
Cameroon	211	246	250	280	260	270	290
Demand	4,127	4,397	4,596	4,783	4,657	4,758	4,900
Europe	1,483	1,511	1,580	1,588	1,540	1,557	1,599
Total Americas	890	876	875	903	875	895	928
Asia and Oceania	876	994	1,048	1,146	1,116	1,161	1,200
S/D balance	(173)	324	3	(47)	32	123	(8)

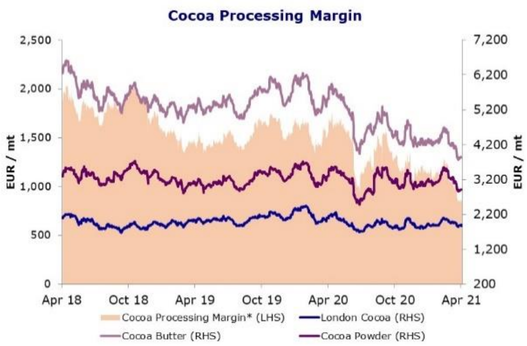
* Figures denoted in thousand metric tons

Source: ICCO, Rabobank 2021

A Preference for Powder

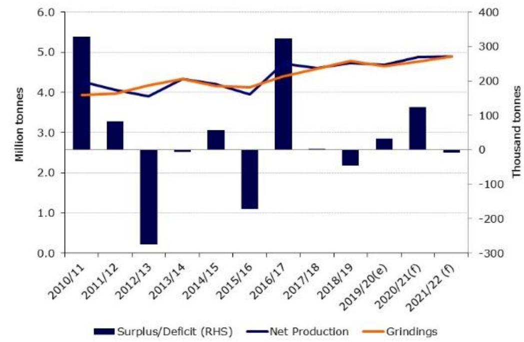
Powder prices have remained robust over the last year, compared to beans and butter, and will likely persist on continued post-pandemic demand growth. A major driver has been strong emerging market imports. This trend was emerging pre-pandemic and will likely see post-pandemic tailwinds. The continued strength in powder demand and prices should cause an improvement in processor margins to pre-pandemic levels, but this might take a bit of time as butter prices continue to lag as out-of-home consumption and sales of beauty products in the US and Europe make a slow recovery.

Figure 8: Declines in European cocoa butter prices have been much higher than those in powder



Source: Bloomberg Finance L.P., Rabobank 2021

Figure 9: Global cocoa surplus/deficit, net production, and grindings



Source: ICCO, Rabobank 2021

Outlook

In our opinion, risks are skewed to the upside, with global demand likely to continue to recover and even increase while production for 2021/22 remains unclear, with potential for lower output than initially expected. Speculators also have the capacity to build a sizeable long position in the coming months, which could catch out short sellers and industry participants with limited forward cover. Despite the recent shift in the shape of the futures curve this may not be maintained. The curve may shift back toward an inversion as the September contract come forward if weather conditions worsens. Those in possession of stocks in Europe may stand to benefit, as the lower availability of stocks compared to the US presents a greater risk of volatility and price spikes in the region.

Imprint

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