Sugar Quarterly

Q1 2020

RaboResearch Food & Agribusiness March 2020

Rabobank

Summary

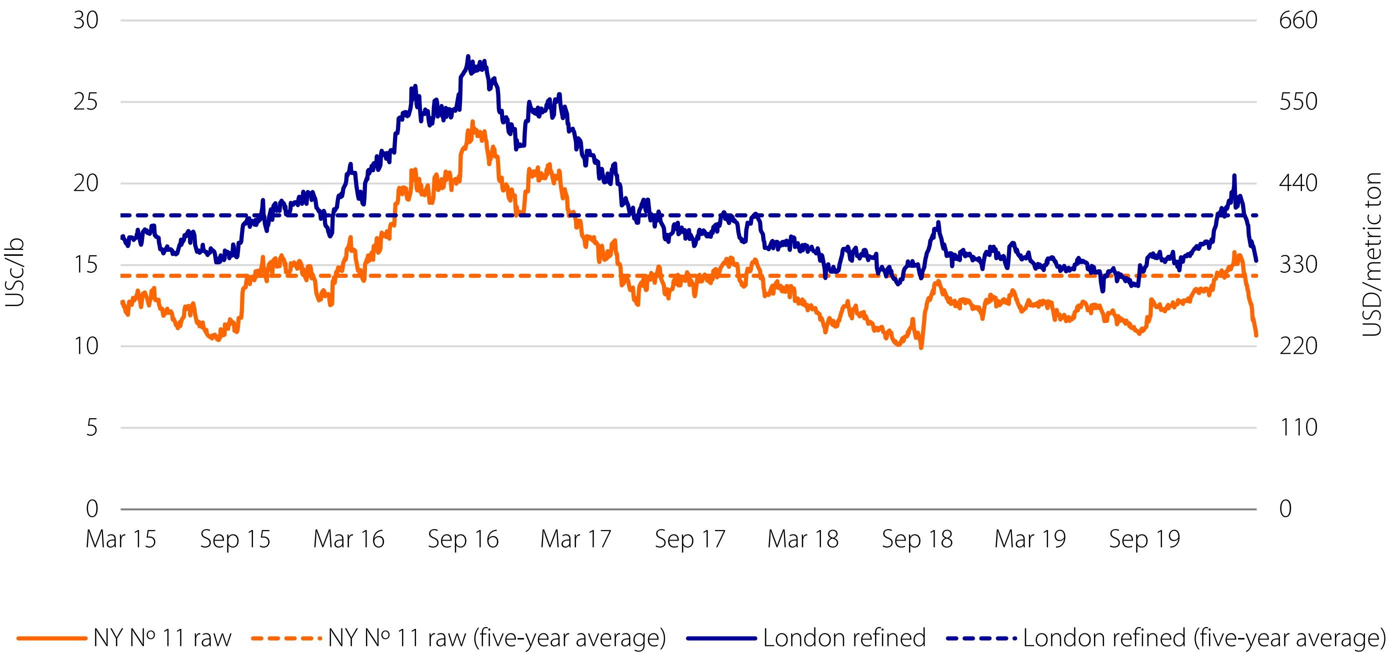
- Early February saw ICE #11 raw sugar futures soaring above USc 15/lb, as the full damage to the Thai harvest became apparent. Soon after, the coronavirus crisis was already undermining prices. It wasn't until Russia abandoned its oil supply pact with OPEC that the real bombshell arrived, as oil plunged to around USD 30/bbl, dragging sugar down below USc 11/lb. The market anticipated that low oil prices would drive Brazilian gasoline and ethanol prices lower domestically, in turn encouraging a large swing from ethanol to sugar in Brazil´s product mix this year.

- On the fundamental side, Rabobank anticipates a 6.7m metric ton global deficit through the 2019/20 (Oct-Sep) season, as deep cuts in Thai and Indian production are partially offset by higher prospects for Brazil – we currently forecast a 45% mix for Brazil's incoming CS harvest. Looking ahead to 2020/21, our early expectations point to a 0.6m metric ton raw value surplus.

- Regarding the effects of the coronavirus crisis on consumption, Rabobank does not foresee a major impact on 2019/20 global sugar consumption but a small erosion in countries severely hit by the virus, resulting in flat demand globally instead of 1% growth. We believe losses in foodservice demand could be offset by an increase in retail and by a possible switch towards more processed food consumption, at the expense of fresh food, given the current situation. For now, we anticipate a return to more 'normal' demand growth in 2020/21.

World Market Prices

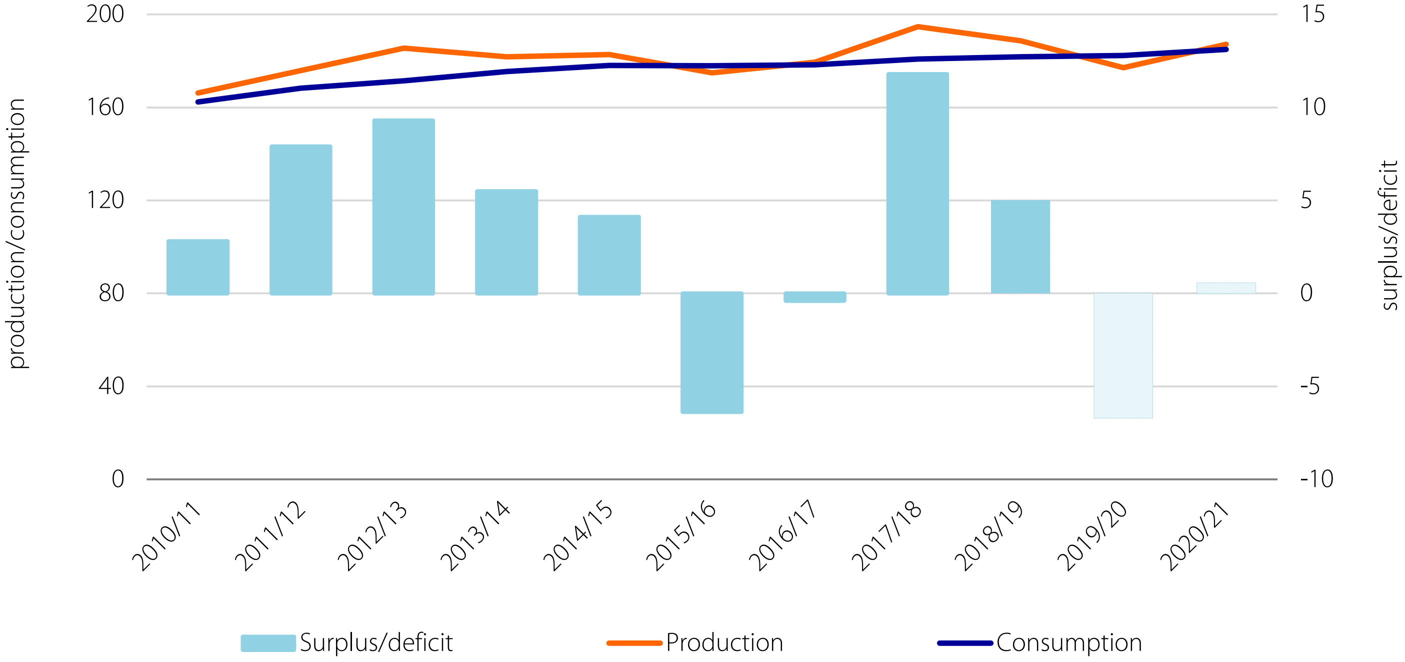
USc/lb, USD/metric ton



Source: Bloomberg, Rabobank 2020

Global Supply/Demand Balance

million metric tons, raw value



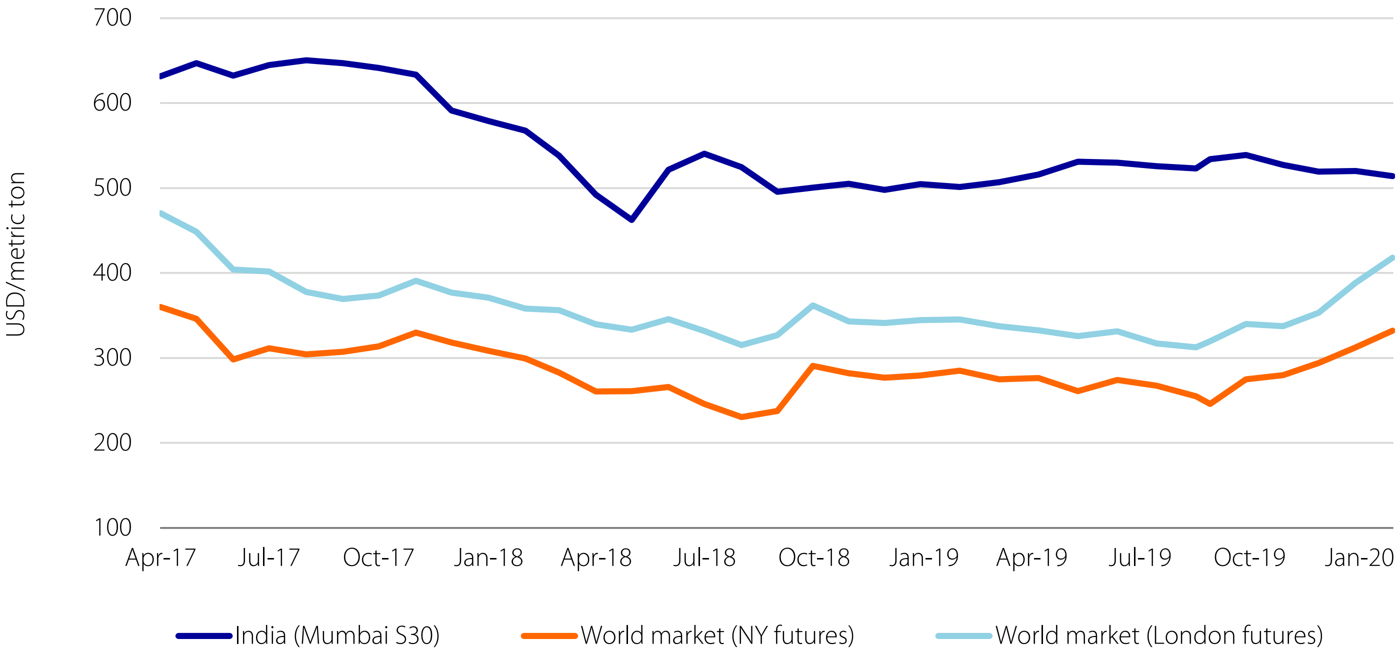
Sources: F.O. Licht, Rabobank 2020

India

- With the 2019/20 crush underway, Indian 2019/20 production continues at a varying pace. In Uttar Pradesh, the harvest pace is matching last season amid a relatively normal year. However, the state of Maharashtra is experiencing a 40% YOY output reduction this season, following early-season dryness and regional flooding. Seasonal sugar output for the state was reported at 5.5m metric tons in mid-March, down from 10m metric tons in 2018/19. On a national level, Rabobank forecasts 2019/20 production at 28.9m metric tons raw value, down 19% YOY.
- Full reservoirs, following the late 2019 monsoon, will be particularly favorable for 2020/21 production. Rabobank forecasts new season output at 33.5m metric tons raw value, assuming no major weather or production risks.
- The Indian government has reallocated export quotas as a means of improving 2019/20 exports. Quotas of 611,797 metric tons have been redistributed between mills, with northern mills in Uttar Pradesh likely benefiting. In addition, Indonesia cut it’s ICUMSA color specifications for raw imports, a move set to benefit Indian-origin raws in particular.
- With ICE #11 futures (basis May 2020) back in the USc 10/lb to USc 11/lb range, levels currently sit below the Indian export parity, despite the recent tumble in the Indian rupee (vs. the US dollar). Should world prices continue to trade below this parity, there is a risk that 2019/20 Indian exports could fall below the 5m metric tons previously forecasted.

India: Sugar Prices

USD/metric ton



Source: Bloomberg, Rabobank 2020

Thailand / China

- Chinese 2019/20 production is forecast at 10m metric tons, down 7% to 9% YOY as the result of both lower acreage and yields in southern China. For next season, the negative impacts of Covid-19 on logistics and labor have delayed spring planting, which could cut 2020/21 output. On the demand side, Rabobank forecasts lower Chinese consumption in Q1 amid the Covid-19 outbreak – particularly for industrial usage – resulting in a 0.3m to 0.5m metric ton decline YOY in 2019/20. That said, sugar usage is forecast to rebound in Q2 as control of the virus improves within China.

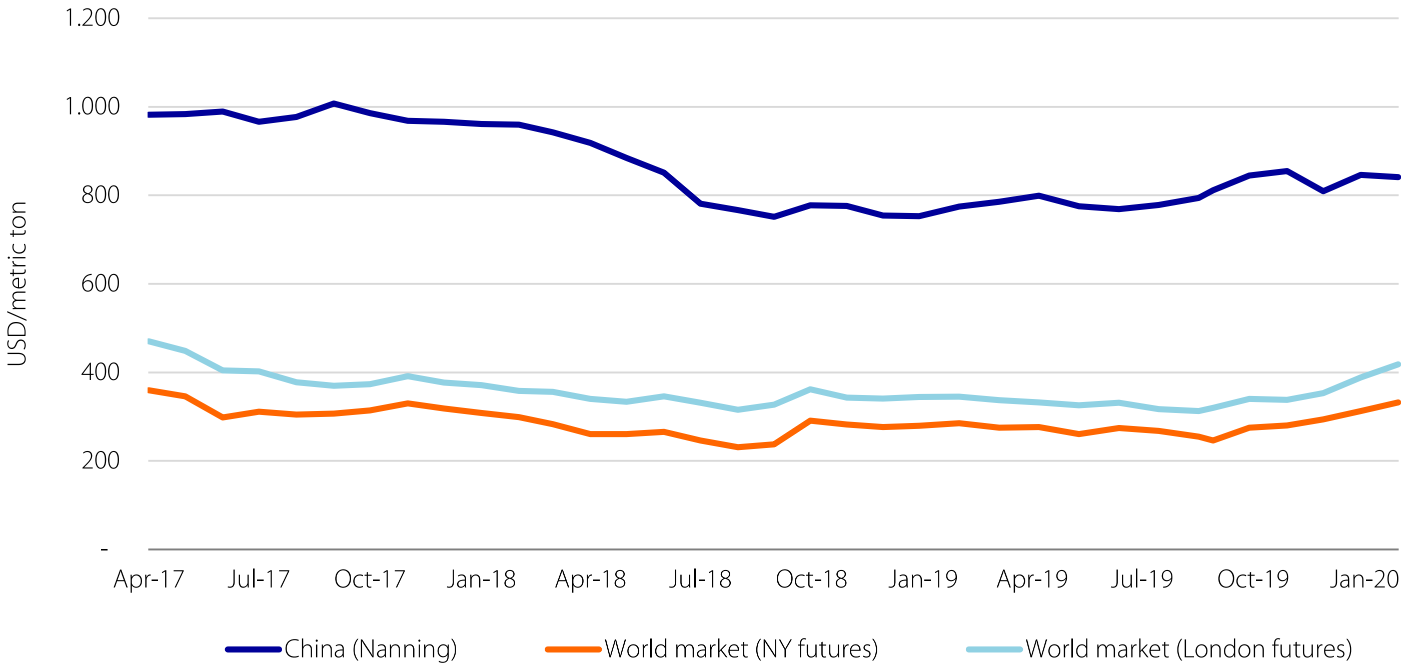
- The Chinese government is anticipated to lower tariffs on out-of-quota imports from 85% to 50%, beginning May 22, 2020. Imports should rise through 2019/20, but shipments could be postponed until after May. Informal volumes are forecast to decline amid stringent inspections. On balance, Rabobank forecasts that the Chinese government will have to sell 500,000 to 800,000 metric tons of state reserve sugar through auction in order to fulfil its domestic supply deficit in 2019/20.

- The 2019/20 Thai cane crop is set to fall 40% YOY, to 75m metric tons, as crushing ends a month earlier than usual. The sharp drop follows a cut in Thai cane acres coupled with seasonal drought. Raw sugar output is set to reach 8.6m metric tons, vs. 15.4m metric tons last year, allowing exports some 6m to 7m metric tons for export and maintaining Thai premiums.

- For the 2020/21 season, Rabobank forecasts little recovery in Thai output, with an early production forecast of 8.6m metric tons. Persistent drought damage, particularly for ratoon crops, and limited replanting incentives are anticipated to keep cane production at similar levels YOY.

China: Sugar Prices

USD/metric ton



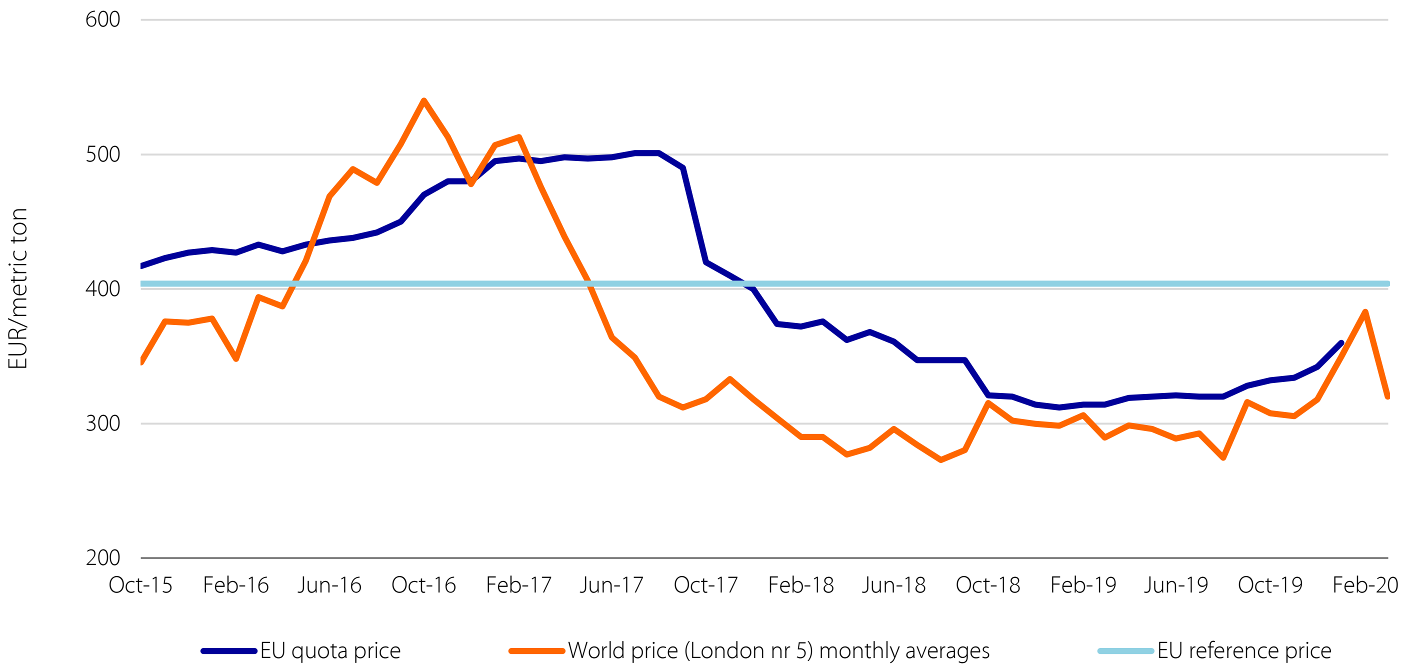
Source: Bloomberg, Rabobank 2020

EU

- The EU has become the epicenter of the Covid-19 outbreak. Local governments have been taking drastic measures, such as lockdowns, to contain the spread of the virus. Although the demand in foodservice is expected to be severely hit for the next two months, we do not expect a big impact on annual sugar demand, as the share of products containing sugar in foodservice is not high, ranging from 17% to 28%, depending on the product category (soft drinks, dairy, confectionery, bakery).
- On an annual basis, we are estimating a 1% decline in sugar consumption in the EU that is partly due to the outbreak and economic slowdown but also in line with a recent downtrend in sugar demand. Currently, we do not foresee a greater impact in demand, as it could be minimized by consumers switching from foodservice to retail. Also, in the event the EU goes into recession, studies have shown that people tend to eat more sugary and processed foods during hard economic times.
- EU-28 sugar production (excluding ethanol) in 2019/20 is expected to be at 17.6m metric tons raw value, while our early projections for 2020/21 are estimated at 18.3m metric tons raw value. We do not expect the virus outbreak to have an effect on production, and the increase in 2020/21 production is expected to come from yields going back to trend levels, while planted area should be slightly down from last year.
- EU white sugar spot prices have been relatively stable since last quarter, at around EUR 465/metric ton (western Europe), while EC-reported prices in January firmed up to EUR 360/metric ton from EUR 342/metric ton in December. It is only a matter of time before the spillover effect of falling global prices adds pressure to European prices.

EU: Sugar Prices

EUR/metric ton



Source: Bloomberg, European Commission, Rabobank 2019

Brazil

- The chaos unleashed in the oil market this quarter by Russia and Saudi Arabia has profoundly affected the Brazilian cane industry´s prospects for the coming 2020/21(Apr-Mar) crop year.

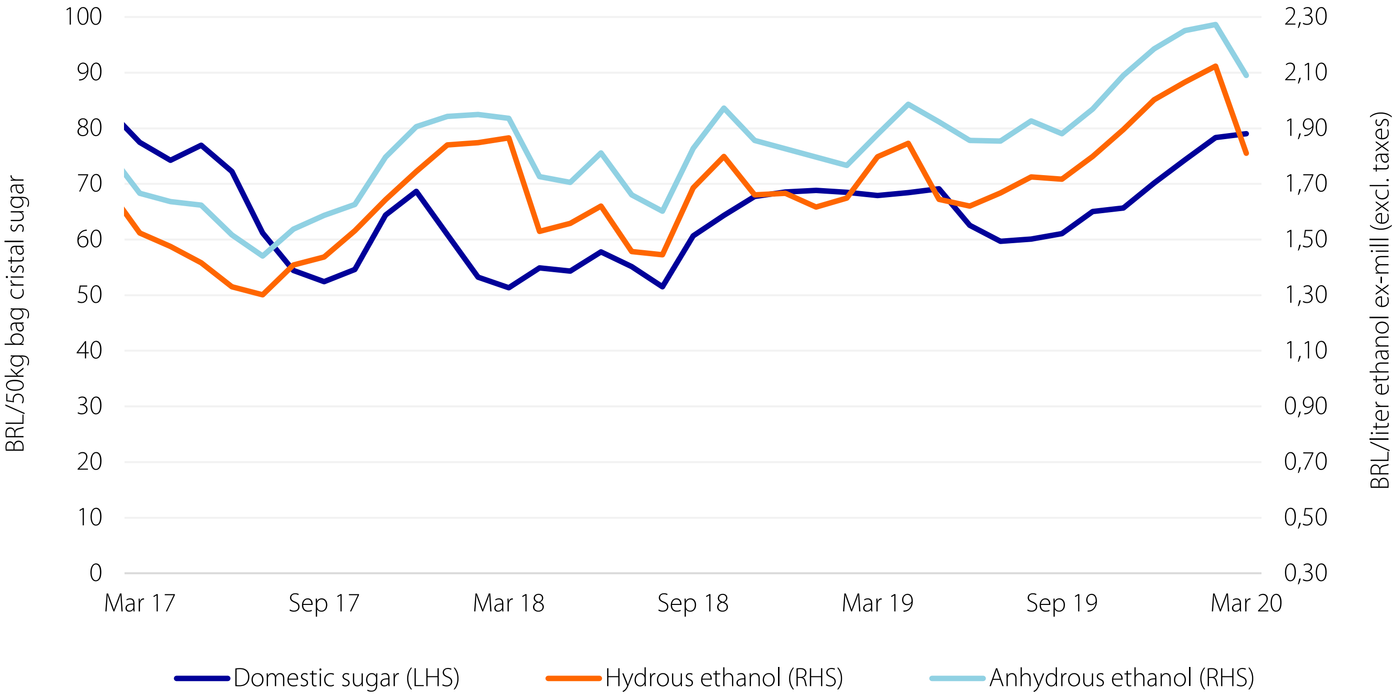
- We estimate that local gasoline pump prices could drop by as much as 15% (vs. 2019) in response to oil´s slump, if the Brazilian real remains weak. Meanwhile, milling is scheduled to begin soon, with the response to the coronavirus crisis already impacting local fuel demand – ex-mill ethanol prices have already fallen sharply. The bottom line is that millers´ ethanol revenues and margins in 2020 look very vulnerable in the face of weeks/months of reduced demand plus the threat of persistently low oil prices. For this reason, the market has priced in a large swing in the mix to sugar.

- Our preliminary forecast is for a Center/South crop of 600m metric tons cane and a mix of 45% sugar in 2020/21 (vs. 34.5% last season) producing some 35m metric tons of sugar and 27bn liters of ethanol. This outlook could still change if, for example, Russia and Saudi Arabia were to show signs of returning to the negotiating table.

- For Brazilian millers, there is some consolation. Markets offered very attractive combinations of sugar futures and FX forwards in January and February. Close to half of projected sugar output is said to have been hedged at prices above the long-term average of BRL 1,230/metric ton (NY FOB equivalent). Even spot values (NY at USc 10.9/lb, 5.06 BRL/USD at the time of writing) give a local currency price of BRL 1,215/metric ton.

Brazil: Sugar and Ethanol Prices

BRL/50kg bag, BRL/liter



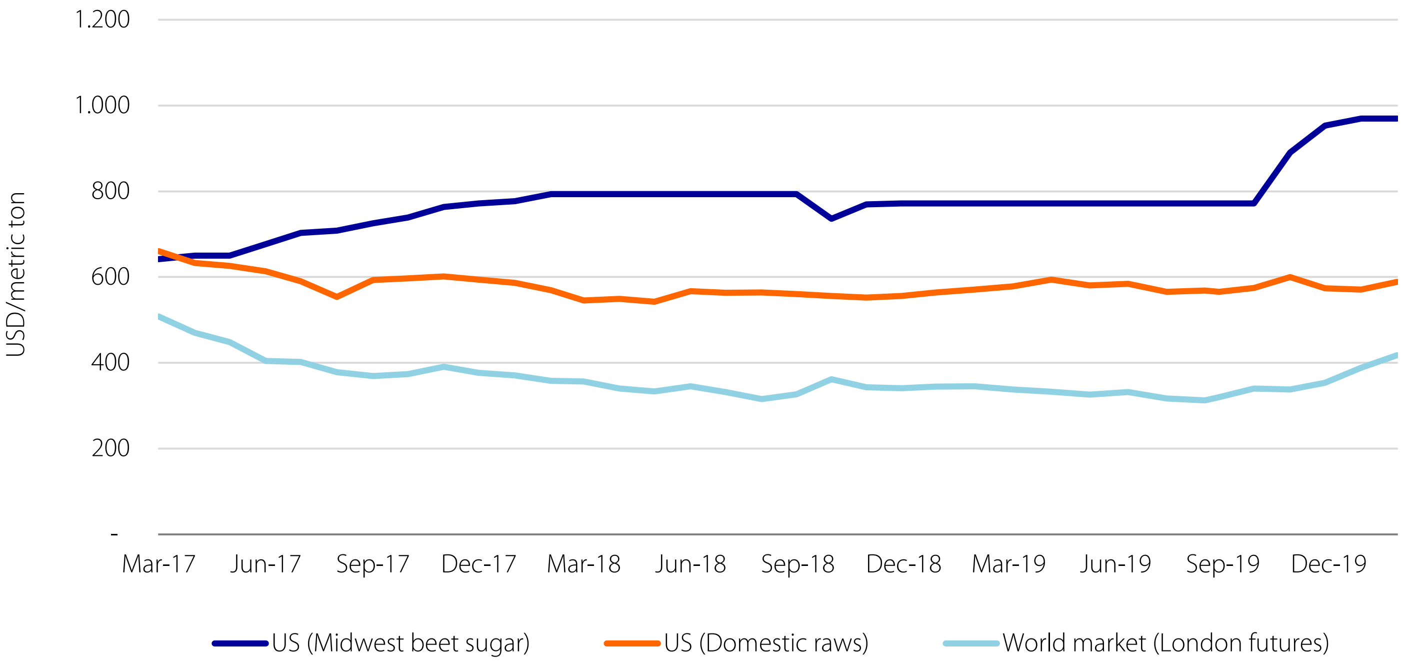
Source: Bloomberg, Rabobank 2020

North America

- The NAFTA market has turned even tighter since last quarter. There have been further reductions in both US and Mexican crops, which caused the stocks-to-use ratio in the US to drop to 7.2% – way below the 13.5% threshold required by the USDA to keep the market balanced.
- The US beet production forecast for the 2019/20 crop is the lowest since 2008/09, and the forecast for cane production the lowest since 2013/14. Adding to the supply scarcity, Mexico's sugarcane production was revised down to 5.5m metric tons raw value, 500,000 metric tons lower than the Mexican government's estimate. As a result, the USDA penciled in imports from Mexico at only 1.06m metric tons raw value, 700,000 metric tons less than needed to fulfill the 13.5% stocks-to-use threshold.
- Soon after the March WASDE, the USDA asked the US Department of Commerce to increase the quantity of refined sugar imports from Mexico by 181,000 metric tons raw value (200,000 short tons) to make up the deficit for the remainder of the 2019/20 marketing year. It is still unclear which actions the USDA will take to fulfill the deficit, but most likely it will come from TRQ allocations, both raws and whites. As last reported in January, refined sugar stocks in the US were 20% lower when compared to the same period last year, while raw sugar stocks were down by 11% YOY.
- This imbalance in raw/refined sugar stocks contributed to widening the spread between raw and refined sugar prices, thus bringing refining margins to record levels not seen since 2011 of USc 17.3/lb. The USDA also increased high-tier imports to 136,000 metric tons raw value, levels not seen since 2009/10, as the spread between US and world refined sugar prices is wide enough to encourage these imports.

US: Sugar Prices

USD/metric ton



Source: USDA, Rabobank 2020

Australia

- Key cane regions along Australia’s northeastern coastline have received ample rain in early 2020, with 600mm to 800mm recorded YTD in Mackay, the Burdekin, and further north through the wet tropics. These conditions have promoted widespread cane growth, improving yield prospects for the incoming 2020 crush. However, weather risks still remain ahead of the crush in June, such as a tropical cyclone or a flood event in North Queensland.
- With domestic cane area falling 11% from 2017 to 2019, Rabobank forecasts a stabilization in area in 2020. Assuming higher YOY cane yields, the 2020 cane crop is forecast at 31m metric tons, suggesting 4.2m to 4.3m metric tons in raw sugar production. This compares to 4.2m metric tons in 2019 and remains below the five-year national average. So far, the sharp fall in world sugar prices has been somewhat insulated locally by significant depreciation of the Australian dollar – the AUD/USD rate now stands at 0.59, having slumped YTD from 0.69.
- Demand for Australian sugar is expected to improve in 2020, amid a cut in Thai supplies. Asian buyers, particularly Indonesia, who rely on Thai imports will need to look to origins further afield. Furthermore, a drought-led fall in Indonesian 2019/20 production – coupled with a growing appetite – are likely to see imports rise towards 5m metric tons, benefiting both Australian and Indian exporters. Rabobank forecasts domestic consumption showing zero growth once again in 2020/21.

Global Outlook

- Sugar is set to take its lead from the oil market in the coming weeks. If Brent oil stays at around USD 30/bbl, average ethanol prices in São Paulo state would just about reach a sugar equivalent of USc 11/lb. Thus any world sugar price much above this level would encourage more sugar production in Brazil at the expense of ethanol production. Oil markets and sugar will be watching closely for signs that either Saudi Arabia or Russia might want to return to the negotiating table

- Despite a backdrop of falling prices, the white premium has surged in recent weeks, with world refined prices falling at a lesser rate than world raws. The reason is threefold: 1) Indian exports have been slower to emerge than expected, 2) news of new refined sugar demand from the US, and 3) unexpected scarcity of Thai refined sugar. Aside from the sweeping impacts of OPEC and Covid-19, the scarcity in the refined sugar market has the potential to drive additional raw demand from refineries.

- The full impact of coronavirus on consumption and disruption in the supply chain remains unclear. As the world struggles to fight off coronavirus, we can expect more logistics bottlenecks, especially delays in ports and borders. So far, governments have prioritized the food & agriculture sector as essential, and efforts to try to minimize any disruptions to the food supply chain should continue.

Global Outlook: Oil Price

Brent, USD/barrel

Source: Bloomberg, Rabobank 2020

RaboResearch Food & Agribusiness

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