



International Sugar Organization

QUARTERLY
MARKET
OUTLOOK

August 2008

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QUARTERLY MARKET OUTLOOK AUGUST 2008

Sugar

The first assessment of the world sugar balance in 2008/09 (October/September) shows world statistical deficit of 3.9 mln tonnes
World production to decrease for the first time since 2004/05
World consumption to grow by 3.8 mln tonnes
No shortages in physical supply are expected
The most constructive sugar fundamentals since 2005/06
Increased volatility of world market prices
Jigsaw world price pattern to continue?
Domestic prices falling in China, rising in India and in the US
Continued BRL appreciation

Special focus

Commodity prices remain high, despite recent downturn
Index fund presence in sugar futures remains strong

World Fuel Ethanol

Global production and consumption to rise by almost a third
US Renewable Fuels Standard boosted by discretionary blending
Robust sales of flex-fuel vehicles in Brazil boosts offtake of hydrous ethanol
whilst millers favour alcohol production
EU using more beet for ethanol
India's blending program frustrated by low ethanol supplies
Thailand's sales of E20 help raise consumption

Alternative Sweeteners

Little reprieve for US HFCS producers from high corn prices
New Sucralose supplier in Europe

Molasses

The prospects of lower supplies mean prices will remain firm

WTO Update

Doha talks fail

RTAs

Disagreements continue over EPAs

International Sugar Organization

One Canada Square
Canary Wharf
London E14 5AA

General Enquiries:
00 44 20 7513 1144

Publications:
00 44 20 7715 9436

E-mail:
economics@isosugar.org
Website:
www.isosugar.org

Contributors:
Mr Sergey Gudoshnikov
Senior Economist

Mr Lindsay Jolly
Senior Economist

Dr Leonardo Bichara
Rocha
Economist

Editor:
Dr Peter Baron

Quarterly Market Outlook

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EXECUTIVE BRIEF

28 August 2008

World Sugar Market

Since our previous *Quarterly Market Outlook* in May, world market prices have continued a rollercoaster ride. On the 5th June the raw sugar price (ISA daily price) was as low as 11.03 cents/lb. Five weeks later on 11th July, the ISA daily price was as high as 15.08 cents/lb, the second highest daily price in 2008. Then, world values suffered from a rapid and significant downward correction. During one day only (17th July) raw sugar futures lost more than 1 cent/lb. At the end of July, a new upward wave started. August demonstrated a jigsaw movement of prices oscillating in a wide range between 14.08 cents/lb and 15.14 cents/lb. White sugar prices followed a very similar pattern. During the period under review the ISO White Sugar Price Index has varied from USD333.10/tonne (15.11 cents/lb) to USD 413.80/tonne (18.77 cents/lb).

In this issue we make our first assessment of the upcoming 2008/09 crop cycle. In 2008/09, for the first time since 2004/05 *world production* is expected to decrease, to 161.649 mln tonnes, raw value, a massive 7.353 mln tonnes down from the last season. *World consumption* is put at 165.547 mln tonnes, raw value, up 2.35%, generally in line with the long-term average growth. The first forecast of the world sugar balance for the period from October 2008 to September 2009 puts world production 3.898 mln tonnes lower than world consumption. Thus, the distinctive global surplus phase has ended and the market is likely to move into a deficit phase.

Production shortfalls are expected to lead to decreases in export availability, on the one hand, and higher import demand, on the other. For the time being, we do not anticipate shortages in physical supply to the world market – global export availability and import demand look well balanced. Most of the production shortfalls in exporting countries are expected to be covered by sugar from stocks accumulated during the two previous surplus seasons. Nevertheless, the trade balance looks relatively tight. If there are currently unforeseen reductions in production and, hence, lower export availability or higher import demand, the forecasted statistical deficit may be accompanied by a supply tightness.

Similar to the previous season the market is expected to be shaped by developments in two sugar giants – Brazil and India. The level of shipments from India, which became a major supply power in the previous season, is of particular importance. At the moment we expect India to export about 2 mln tonnes despite a significant drop in domestic production. If, however, India reduces deliveries to the world market significantly below this level due to economic or political reasons, the forecasted fragile balance between global export availability and import demand will disappear. Similarly, in the case of Brazil, if the real demand for ethanol happens to be higher than our forecast, or if weather calamities reduce considerably cane production and sugar contents, the market may face a significantly more serious supply tightness than currently anticipated.

How can our understanding of the current supply/demand current situation (the return of world sugar fundamentals to a global deficit with a still high level of stocks accumulated during two previous surplus seasons) be interpreted in terms of future market values? Clearly, final numbers may differ from these early forecasts but the current fundamental outlook is the most constructive for market values since 2005/06. The question is whether non sugar-specific drivers (including the outlook for crude oil and other hard and soft commodities, exchange rate fluctuations, developments in ethanol production and use, the upsurge in renewable energy programmes and continuing criticisms over use of food crops for energy, the general outlook for different classes of investment assets, and last but not least funds activity in sugar futures markets) will mitigate or reinforce a positive fundamental picture.

A summary of the first assessment of the world sugar balance in 2008/09 is provided in the table below.

World Sugar Balance
(mln tonnes, raw value)

	2008/09	2007/08	Change	
			in mln t	in %
Production	161.649	169.002	-7.353	-4.35
Consumption	165.547	161.752	+3.795	+2.35
Surplus/Deficit	-3.898	+7.250		
Import demand	46.702	45.506	+1.196	+2.63
Export availability	46.791	47.926	-1.135	-2.37
End Stocks	65.230	69.217	-3.987	-5.76
Stocks/Consumption ratio in%	39.40	42.79		

Currency Movements

In aggregate terms, ISA prices rose by 9.8% over the past six months. The strengthening of the BRL has lowered the world sugar price rise when expressed in Brazil's national currency to only 2.8%. The Thai Baht and the Australian Dollar have by contrast weakened against the USD over the period, which has pushed up sugar prices expressed in local currency further. Among the major sugar importers, the Japanese Yen (JPY) has weakened significantly against the USD – world prices expressed in JPY are now 19% higher than in March.

Domestic Prices

Domestic sugar prices rose sharply in India and in the US over the past 6 month period. In China, by contrast, domestic sugar prices have plummeted. Domestic prices fell slightly in Russia, while in Brazil prices started falling between March and June, with the onset of the Centre-South harvest, but recovered their losses over the past couple of months.

Special Focus

During July, the price of most agricultural commodities suffered a downturn while sugar prices increased. In terms of monthly averages, however, the prices of agricultural commodities are today still higher than at the beginning of 2008. This edition of the QMO offers an analysis on commodity prices and commodity indices, focusing on energy and agricultural commodities, including softs and grains. In the year to August 21st, the DJ and the GS Commodity Indices have accrued positive returns of 6% and 24% respectively. Of importance, hedge and index fund investment in sugar futures during August 2008 remains significantly greater than in any period of 2007.

Fuel Ethanol

In 2008 global fuel ethanol production and consumption is forecasted to rise by almost a third to a record high of 65.7 bln litres. In the US the Renewable Fuels Standard (RFS) mandates sharply higher inclusion in 2008 and discretionary blending is further boosting consumption. In Brazil robust sales of flex-fuel vehicles is driving offtake higher. New and increased inclusion mandates boosts EU consumption. India's fuel ethanol programme is falling behind target whilst in Thailand production capacity still remains in excess of domestic offtake. Brazil will be the key origin of internationally traded ethanol with the US and the EU are likely to remain key markets. Prices for ethanol have remained firm in the US over recent months whilst in Brazil ample supplies have also pressured prices lower.

Alternative Sweeteners

In the US by-product credits have failed to keep pace with the very pronounced rise in corn prices this year, resulting directly in a surge in net corn sweetener costs for HTCS producers.

In May, Dublin and Geneva-based Fusion Nutraceuticals, in partnership with Indian pharmaceutical company Alkem, announced it was targeting industrial ingredient use in Europe for their intellectual property validated *sucralose*. Manufacturers are getting more adventurous over *erythritol* use since it gained EU-wide approval this year. Although Arla Foods halted production of the sweetener *tagatose* in 2006, the sugar substitute has been taken up by Nutrilab, which has adapted the production process and sees a strong future.

Molasses

Fundamentally, molasses faces a tighter market over coming months with little to suggest that price will ease. Production is already anticipated to decline in the 2008/09 season in key exporting countries, particularly India, and domestic demand is also on the rise as ethanol demand strengthens. However, should grain prices weaken further from their recent highs, molasses incorporation rates in livestock feed may fall in the key importers - the US and the EU - as high molasses values would dampen enthusiasm about molasses as a feed ingredient.

WTO

Governments' latest attempt to salvage a deal in the Doha Round of trade talks broke down on Tuesday 29th July, as ministers acknowledged that they were unable to reach a compromise after 9 days of a high-level summit at the WTO headquarters. The multilateral negotiations on agriculture and non-agricultural market access (NAMA) now face an uncertain future.

Regional Trade Agreements

At the ACP Council of Ministers convened in June, officials from 79 African, Caribbean and Pacific (ACP) states laid out their stances on several controversial issues, including Economic Partnership Agreements with the European Union.