International Sugar Organization

QUARTERLY MARKET OUTLOOK

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Sugar

Projected world deficit for 2008/09 (October/September) upgraded to 4.3 mln tonnes
World production to decrease by 7.1 mln tonnes from the previous year
World consumption to grow by 3.7 mln tonnes
The most constructive sugar fundamentals since 2005/06
World market values on slow but steady growth path on the back of constructive fundamentals
Strong USD appreciation against currencies of most exporters and importers
Significant BRL depreciation

Special focus: Ocean Freight Rates and the World Sugar Market

Commodity prices to continue to drive freight rates
Vessel availability to dampen mid-term outlook of freight
Generally lower rates for bulk sugar freight vis-à-vis the white sugar premium

Commodity Prices

Sharp fall in general commodity prices from the July 2008 peak
Grain prices relatively resilient over the mid-term
Cocoa prices at almost 30 year record highs

World Fuel Ethanol

Growth in global fuel ethanol production forecasted to halve in 2009
Challenging year ahead due to the credit crunch and lower crude oil prices

Alternative Sweeteners

US HFCS producers win small price rise
FDA approval boosts prospects for Stevia sweeteners

Molasses

Sharp contraction in export availability a key driver in the coming year

WTO Update

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RTAs

Cameroon & EU sign interim EPA

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EXECUTIVE BRIEF

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World Sugar Market

Since our previous *Quarterly Market Outlook* in November, world market prices have shown a slow but steady improvement on the back of constructive sugar market fundamentals. The ISA daily price for raw sugar improved from 11.02 cents/lb on 5th December to 13.50 cents/lb in mid-February. White sugar prices followed a very similar pattern but the rally has been more pronounced. The ISO White Sugar Price Index grew from USD300.75/tonne (13.64 cents/lb) on 5th December to USD399.75/tonne (18.13 cents/lb) on 13th February.

In this issue we make our third assessment of the world sugar balance for the period from October 2008 to September 2009, which has strengthened our general view of the global supply/demand situation. *World production* is put at 161.527 mln tonnes. A significant production shortfall in India and a further contraction of production in the EU, on the one hand, and a continuing expansion of sugar output in Brazil, on the other hand, are the three major supply features of 2008/09. The combined effect of output reductions in the EU and India is expected to shave off a massive 7.084 mln tonnes from world sugar supply, despite record high growth in sugar output in Brazil. So far, a lowering in forecasted production in India (from 23.915 mln tonnes projected in August to the current projection of 19.55 mln tonnes) has been neatly matched by a practically identical increase in Brazil (from 33.215 mln tonnes to 37.540 mln tonnes, respectively). Meanwhile, *global consumption* is forecasted to grow at the rate of 2.19% to 165.801 mln tonnes, raw value. Of importance, the ISO expects only a minimal impact of a still uncertain global economic slowdown on sugar consumption during the remaining months of 2008/09. World production is now expected to be 4.274 mln tonnes lower than world consumption as against 3.626 mln tonnes projected in November. Consequently, the statistical outlook for the market till the end of the season in September 2009 remains constructive and supportive to world market values.

Despite a forecasted decrease in world sugar output, world export availability is expected to rise due to projected growth in output in exporting countries, mainly in Brazil (in 2008/09, if our projection is validated by actual shipments, every second tonne of sugar traded internationally will come from Brazil). The ISO puts *world export availability* for 2008/09 at 49.608 mln tonnes, raw value, as against 46.245 mln tonnes in the previous crop cycle. Smaller output in importing countries and in India, in particular, is expected to trigger additional *import demand* which is estimated to reach 49.621 mln tonnes, up 3.673 mln tonnes. For the time being, the additional import demand seems to be met by export availability (including the use of sugar from stocks) but the trade balance for the period till next September looks tight.

Seemingly, the sugar market fundamentals have reasserted themselves. It also has to be noted that although the role of powerful 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, funds activity in sugar futures markets, etc.) has seemingly diminished during the period under review, they may still both mitigate and reinforce the fundamental picture in future.

A summary of the second revision for 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	161.527	168.611	-7.084	-4.20
Consumption	165.801	162.241	3.560	2.19
Surplus/Deficit	-4.274	6.370		
Import demand	49.621	45.948	3.673	7.99
Export availability	49.608	46.245	3.363	7.27
End Stocks	66.272	70.533	-4.261	-6.04
Stocks/Consumption ratio in%	39.97	43.47		

Currency Movements

The past few months have been marked by a significant appreciation of the USD with respect to the currencies of most major sugar exporters and importers. The stronger dollar has cushioned the past 6 month sugar price falls when expressed in national currencies. Among sugar exporters, the largest USD appreciation has occurred against the Brazilian Real (BRL) at 43%, followed by the Australian Dollar (AUD) at 31%, the South African Rand (ZAR) at 29% and the Colombian Peso (COP) at 22%. The ISO sugar weighted exchange rate index shows that in 3 exporting countries currencies have suffered from a relative long-term devaluation against the US Dollar. These are South Africa, Colombia and Brazil. These three countries are seen to have gained exchange rate competitiveness in sugar exports. All other countries, including India, Guatemala, Thailand and Australia have lost competitiveness in currency movements over the longer term, as they lie below the sugar weighted exchange rate line.

Domestic Prices

While domestic sugar prices have fallen in China over the past 12 month period, they have risen sharply in Brazil and in India and to a lesser extent in Russia. Domestic prices expressed in national currencies show a strong disconnection from the line of world prices expressed in US Dollars, which reflect different national fundamentals as well as exchange rate movements and border protection.

Special Focus: Ocean Freight Rates and the World Sugar Market

Over the past few years, freight rates have added a great level of volatility to the c.i.f price of sugar. Demand and supply factors are heavily impacting the world freight market. On the demand side, the major commodity directly impacting the freight market is iron ore, due to its 25% share in the bulk freight market. Demand for iron ore started to skyrocket around the middle of the decade due to record rates of economic growth in China, which prompted the country's imports of the commodity to rise five-fold between 2001 and 2008 to 450 mln tonnes. On the supply side vessel availability is the major driver. Indeed, the change in the supply and composition of the bulk vessel fleet has been a major determinant of freight rates over the recent months. The world's shipyards have processed a record number of orders for new vessels, in particular the larger sized Handymax (40k to 60k deadweight tonnes) and Panamax (60k to 100k dw. tonnes) vessels. This is set to accelerate over the coming months, dampening the prospects of immediate freight rate rises. The implications for sugar are: a) the larger concentration in the world raw sugar trade trade in a handful of destinations is likely to bring sudden spurts of volatility to the volumes of raw sugar traded by route as demand for commodities swings; b) the whites market will continue to see an increasing volume of sugar being shipped in containers.

Commodity Prices

In July 2008, commodity prices reached a historic high. However, since then commodity prices have had a sharp downward correction. The sharpest drop was observed for the price of Brent crude oil prices, which collapsed from an average of USD 134/barrel in July 2008 to an average of only USD 42/barrel in January 2009, a 66% drop. Food commodity prices declined to a lesser extent, by an average of only 28% since July. Commodities faring particularly well recently are cocoa, whose prices are at almost 30 year highs, and grains such as soybeans, maize and wheat, whose prices in January 2009 were a respective 86%, 80% and 56% higher than in January 2005.

Fuel Ethanol

Global fuel ethanol production and consumption growth is forecasted to halve in 2009, growing by around 14% to reach around 75 bln litres. This slowing in output growth would be a landmark, given the previous years' high growth rates, largely explained by a massive increase in production capacity in both the US and Brazil. A halving in growth from the previous year is due to economic challenges from falling crude oil prices and the credit crunch that has beset the industry in several countries. Whilst 2008 was also generally perceived as a challenging year for biofuels, global output is estimated to have reached 65.3 bln litres, up 32% from the 2007 level. The commodity price boom drove food and energy prices to new highs during the first half of the year, intensifying the flames of the fuel vs food debate, and as well as to boost production costs substantially for fuel ethanol manufacturers, denying them the benefit of record high crude oil prices. Suddenly the price boom ended during the second half of the year, world crude oil price retracted rapidly and the US dollar appreciated significantly. The negative impacts of these factors on global fuel ethanol consumption and production will be fully felt in 2009.

Alternative Sweeteners

Negotiations between *HFCS* producers and large users over annual supply contracts for 2009 were settled later than normal, as buyers were wary of entering into agreement whilst corn values were falling from the peaks seen mid-year. Contract prices have reportedly been raised by 0.5 US cents/lb, wet basis in some instances whilst other companies received a roll-over (no price increase).

In the United States, the Food and Drug Administration (FDA) in December gave the long-awaited green light for Reb A, the sweetener made from the *stevia* leaf, to be used in food and beverages. Coca-Cola and PepsiCo immediately announced that their first drinks sweetened with Reb A would shortly be available in US shops. Coca-Cola has partnered with Cargill to develop their rebiana brand called Truvia, and PepsiCo, along with Whole Earth Sweetener Company (a subsidiary of Merisant Company) and PureCircle, have their own product under the PureVia brand.

Molasses

Relatively high molasses values are not anticipated to weaken over the coming 6 months. Molasses availability to the world trade is forecasted to shrink, particularly due to lower production in India and Pakistan. This together with expanding use of molasses in fuel ethanol programs mean that the molasses trade will be characterised by constrained supplies and uncompetitive values over coming months.

WTO

Trade ministers from 24 countries pledged to resist protectionism and strive to conclude the seven-year-old Doha Round of trade talks before the end of the year, according to a statement that emerged from an informal high-level gathering on the sidelines of the World Economic Forum in Davos.

Regional Trade Agreements

The European Union and Cameroon signed an interim bilateral trade agreement - a stepping stone to a full Economic Partnership Agreement (EPA)- on 15th January, which will give Cameroonian exports duty-free and quota-free access to the European market. In turn, Cameroon has agreed to lift tariffs on 80% of EU imports over the next 15 years.