International Sugar Organization

QUARTERLY MARKET OUTLOOK

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One Canada Square
Canary Wharf
London E14 5AA

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General Enquiries:
+44 (0) 20 7513 1144

Publications:
+44 (0) 20 7715 9436

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

Contributors:
Mr. Sergey Gudoshnikov
Senior Economist

Mr. Lindsay Jolly
Senior Economist

Dr. Leonardo Bichara Rocha
Senior Economist

Editor:
Dr. Peter Baron

EXECUTIVE BRIEF

13 May 2010

World Sugar Market

The third revision of the world sugar balance forecast for the period from October 2009 to September 2010 shows a decrease in the gap between world consumption and global output. The world sugar economy is still facing the second consecutive year of a significant statistical deficit. ***World production*** is now put at 158.189 mln tonnes, raw value, up by 6.420 mln tonnes or 4.23% from the last season. Since our previous *Quarterly Market Outlook* was released in February, the main change in sugar fundamentals has been an unexpected improvement in sugar production in India. A 2.5 mln tonne increase in output (and a symmetrical decrease in import demand) overshadows other smaller changes in the supply/demand situation of individual countries. ***World consumption*** is expected to grow at a rate significantly lower than the long-term 10 year average (1.66% and 2.64%, respectively). The lower growth is attributed to extremely high world market prices in the second half of 2009 and the first months of 2010, still soaring domestic prices, as well as some lingering impacts of the 2008/09 global recession on sugar consumption growth rates. The ISO does not anticipate that the projected renewed global economic growth will significantly stimulate sugar consumption in the course of 2009/10. Even so, global use of sugar is expected to reach 166.701 mln tonnes. Therefore, the growth in global production is far too small to cover anticipated increases in sugar consumption, and the ***world statistical deficit*** is expected to reach 8.512 mln tonnes compared to 9.425 mln tonnes projected in February.

It is important to stress, that the distinctive deficit phase is expected to come to an end with the start of the new crop year in October. In this issue we provide our preliminary thoughts on the market fundamentals in the coming two seasons. For the time being, the ISO expects sugar production during the next crop cycle to increase in Brazil, India, Mexico, FSU countries, as well as in some LDC exporters in Sub-Saharan Africa, but assumes a decrease in beet sugar output in the EU. This will likely bring a world sugar surplus of about 2.5 mln tonnes. Looking further ahead, world production and consumption may be neatly balanced in the following 2011/12 crop cycle with a further growth in Brazil's sugar output.

Importantly, the new season will start with a critically low level of stocks. The stocks/consumption ratio has not been as low as the current 31.7% for 20 years – since 1989/90. An anticipated modest global surplus is likely to increase this ratio to about 32.4%.

Since February, world market prices have fallen abruptly. The ISA daily price collapsed from 27.37 cents/lb at the beginning of February to 14.45 cents/lb only on 7th May, the lowest daily quotation since April 2009. Thus, during the three months in question raw sugar prices have lost more than 47% of their value. The price fall was equally stunning in the case of white sugar. The ISO White Sugar Price Index decreased from USD 736.45/tonne (33.40 cents/lb) at the beginning of February to USD424.30/tonnes (19.25 cents/lb) only on 7th May.

The past two months proved to be a watershed between a record high world deficit and a looming global surplus. Not surprisingly, during a time of radical changes in fundamentals the market is nervous and prices are volatile. It can be also argued that the abrupt price fall to 12-month lows may be a sign that its previous rise to 29-year highs was too high and too fast for importers, so prices fell back to "find" demand levels. However, it remains to be seen how much further world prices might fall before fresh physical demand is stimulated.

A summary of the revised world sugar balance in 2009/10 is provided in the table below.

World Sugar Balance
(mln tonnes, raw value)

	2009/10	2008/09	Change in mln t	in %
Production	158.189	151.769	6.420	4.23
Consumption	166.701	163.983	2.718	1.66
Surplus/Deficit	-8.512	-12.214		
Import demand	52.896	50.167	2.729	5.44
Export availability	52.288	49.216	3.072	6.24
End Stocks	52.772	60.676	-7.904	-13.03
Stocks/Consumption ratio in%	31.66	37.00		

Currency Movements

Currency movements have been relatively mild over the past 6 months. However, among some importers, there has been more volatility. India and Indonesia's currencies have appreciated by about 5% against the USD, while the Euro has depreciated by 10%, meaning that prices paid to EU quota holders have declined in real terms.

Domestic Prices

Against the trend of world prices, domestic sugar prices have risen in Russia and have reached a record level in China and Brazil since November. Generally speaking, domestic prices are much higher today than a year ago. In Mexico and Brazil, they have risen by a respective 70% and 60% since May 2009, in China, US and India by around 40% and in Russia prices are today 25% higher than in May last year. They have since fallen in India, where the cane harvest in 2009/10 proved to be much higher than earlier expectations.

Special Focus: Status Quo and Outlook for Brazil's Sugar Cane Industry

Brazil is bracing itself for a bumper cane crop this year, and sugar output is estimated to rise by 4 mln tonnes. Indicative that expansion will be large in 2010/11 is the good weather conditions so far, the healthy growth in demand for new harvesters as well as the reactivation of idle crushing capacity in mills facing financial difficulties. Meanwhile, independent growers are struggling with rising production costs, which have been reportedly higher than prices received for the cane over the past 3 years. There were 12 mergers and acquisitions in Brazil's sugar and ethanol sector during the first three months of 2010. Total activity in 2010 is set to surpass the level achieved during 2007 or the pre-financial crisis level. Through mergers and acquisitions, Brazil's largest sugar groups have been gaining strength and market share, while capital injection is helping tackle the high level of indebtness of the sector, which, according to Itau Bank, reached BRL 46 bln in 2009/10. Foreign groups like Bunge, Tereos and Louis Dreyfus have entered the group of the top 5 producers in the country through an aggressive policy of acquisitions of mills. Two oil companies have also entered the sector. In January 2010, Cosan and Shell signed a USD 8 bln joint venture for ethanol production and distribution in Brazil. Meanwhile, Petrobras, Brazil's oil giant, has recently entered an agreement with Tereos International, of up to BRL 2.2 bln. In short, rather than seeing the emergence of a string of new independent mills, Brazil's sugar cane industry is experiencing consolidation – only 2 new mills are reported to come onstream in 2011/12. Despite a bearish outlook on sugar, the Brazilian cane industry will continue to expand over the longer term as growth in the captive domestic market for ethanol shows no signs of abating.

Commodity Prices

Commodity prices showed resilience over the first quarter of 2010, with the IMF Index for Fuel and Non-Fuel Commodities rising 5% between December 2009 and March 2010. However, food commodity prices (comprising cereals, vegetable oils, protein meals, meats, seafood, sugar, bananas and oranges) were flat in the first quarter of 2010. Meat prices have the highest quarterly gains (20% for beef and 15% for swine). Grains and soft commodities had a rougher first quarter in 2010, with prices throughout retreating relative to end 2009 values. Sugar prices had the highest quarterly fall across the whole commodity portfolio.

Fuel Ethanol

Global fuel ethanol production and consumption in 2010 is forecasted to grow by around 12%, reaching 82.4 bln litres. This is a similar rate of growth to that of last year but still far below the average growth of 28% over the prior 3 years. There are new and expanding consumption mandates in the US, several countries in Central and South America, and the EU. Further growth in Brazil's domestic ethanol consumption is also anticipated. US ethanol producers are benefiting from continuing lower corn prices and improved margins this year and mandated inclusion is growing under the Renewable Fuels Standard by 14 % in 2010. Brazil's ethanol output is expected to rebound considerably after having contracted in the past campaign for the first time in 10 years. An expected large rise in cane supply will help boost ethanol output, ensuring that continued growth in domestic offtake can be met. Elsewhere, commissioning of new production facilities underlies strongly growing production in the European Union. Thailand's fuel ethanol market is expected to grow considerably with the commissioning of several new distilleries but output is likely to be below full capacity because of continuing high feedstock prices. In India, limited availability of molasses together with strong competition from the industrial alcohol sector is forecasted to result in a modest fall in fuel ethanol output in the coming year. Brazil's tight supplies and boosted prices saw global fuel ethanol trade contract significantly last year. However, there is potential for limited growth in traded volumes in 2010 on expectations that Brazil's ethanol production will rise.

Alternative Sweeteners

In the United States **HFCS** has considerably improved its competitiveness against sugar with very high wholesale sugar prices and more recently with a paring pack in HFCS values. Whilst this provides an incentive for boosting HFCS offtake, the key factor suggesting a 1% rise in domestic deliveries during 2010 is an anticipated fallback in imports of direct consumption sugar from Mexico. In 2010, the volume of US HFCS imported by Mexico should keep growing. HFCS consumption there is anticipated to almost double in 2009/10, with carbonated softdrink bottlers using more HFCS than sugar. Meanwhile GLG Life Tech has reported a massive increase in revenue during 2009 as food and drink manufacturers continue to develop and launch new products containing its **stevia**-derived sweeteners. The company has announced collaborative marketing agreements in two key markets for the plant-derived sweetener: Australasia and South America. In Europe, stevia suppliers have welcomed the European Food Safety Authority's recent positive scientific opinion on the safety of stevia-derived sweeteners. BioVittoria, the world's largest producer and processor of **luo han guo** (monk fruit), in January this year received regulatory approval in the US.

Molasses

Molasses prices remain high after rising in 2009 to unprecedented levels at both origin and destination. Global molasses trade contracted in 2009 not just reflecting the supply side factors - a sharp fall in molasses production and tradable surpluses - but also the relatively lower grain prices which made molasses values uncompetitive in compound feed manufacture. Furthermore, tradable surpluses were also impacted by an expanding use of molasses in fuel ethanol programs. Prices may begin to weaken later in the year should prospects point to boosted molasses production as a consequence of a likely higher global sugar production after two years of global deficit.

WTO

The WTO Doha Round negotiations are in their ninth year. The WTO's week-long "stocktaking", held in Geneva from 22 to 26 March, failed to advance prospects for a global trade deal. The much-touted goal of concluding the negotiations before the end of 2010 - an objective laid out by heads of state last year - was set aside, as officials acknowledged that political hurdles continue to block progress in the round, much as they have for the past 18 months.

Regional Trade Agreements

A group of West African countries and the European Union in March crept closer to reaching a trade deal during negotiations in Brussels, although long-standing disagreements remain. The Economic Community of West African States (ECOWAS) - a regional group of 15 countries that is joined by Mauritania in these talks - is one of five African bodies negotiating Economic Partnership Agreements (EPAs) with the EU. Peru and Colombia have concluded 3 years of free trade negotiations with the EU, gaining considerable tariff savings in several key agricultural commodities, including sugar. Many Caribbean Community member states, which signed an EPA with the European Union in 2008, have expressed concern over the Andean deals' impacts on the trade preferences (full duty-free access) that their exports currently enjoy in the EU.