



International Sugar Organization

QUARTERLY  
MARKET  
OUTLOOK

February 2008

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# QUARTERLY MARKET OUTLOOK FEBRUARY 2008

## **Sugar**

The third assessment of the world sugar balance in 2007/08  
(October/September)

Statistical Outlook bearish despite a decreased gap between world production and consumption

World market price rally contrary to bearish fundamentals

Funds' involvement disconnects sugar prices from fundamentals

Continued USD weakness

World prices in national currencies rising

Domestic prices falling in the US

## **Special focus**

High energy prices and rising inflation favouring funds investment in commodities

Growing number of long positions held by commodity index funds in sugar futures causing prices to rally

## **World Fuel Ethanol**

Global production and consumption set to surge to record levels in 2008

New Energy Bill mandates sharply higher inclusion from 2008 onwards

Brazil's production and use driven higher by robust sales of flex-fuel vehicles

New inclusion mandates in the EU

India's blending program advances

Thailand's government looks to greater sales of E10

## **Alternative Sweeteners**

Much higher by-product prices soften blow of sharply higher corn costs for US HFCS producers

New hope for Stevia as Cocoa-Cola and Cargill form alliance to market new sweetener

## **Molasses**

Buoyant cereals prices boost molasses values

## **WTO Update**

WTO members aim for a modalities agreement in agriculture trade negotiations around Easter

## **RTAs**

CARIFORUM agrees EPA with the EU, including greater sugar access

# International Sugar Organization

One Canada Square  
Canary Wharf  
London E14 5AA

General Enquiries:  
00 44 (0)20 7513 1144

Publications:  
00 44 (0)20 7715 9436

E-mail:  
[economics@isosugar.org](mailto:economics@isosugar.org)  
Website:  
<http://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

February 2008

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*The views expressed in this document are those of the ISO Secretariat. They do not necessarily represent the views of the ISO Members.*

## EXECUTIVE BRIEF

25 February 2008

### World Sugar Market

In this issue of the *Quarterly Market Outlook* we make our third assessment of the world sugar balance for 2007/08 (October/September). From the very beginning of the season, the ISO has suggested that the world sugar economy is facing the second consecutive season of a massive gap between world production and consumption. The second revision of the world sugar balance forecast for the period from October 2007 to September 2008 has not changed our general view of the global supply/demand situation. World production is expected to be 9.309 mln tonnes higher than world consumption. Although this represents a downgrading from 11.139 mln tonnes expected in November, the statistical outlook for the market up till the end of the season in September 2008 remains bearish and little upward pressure is expected on world market values by sugar fundamentals.

The bearishness of the statistical outlook is further reinforced by the projected trade surplus and high level of stocks. World export availability is expected to exceed import demand by a massive 3.3 mln tonnes. Ending stocks are projected to grow by 6.0 mln tonnes by the end of the season, increasing the stocks/consumption ratio to 46.5% as against 43.9% in 2006/07 and 37.7% in 2005/06. Of importance, first indications show that there is a probability of better balanced world production and consumption with still a sizeable trade surplus in the next season to start in October 2008.

On the supply side, the major correction has been made for India. Based on the latest government and industry's production projections, we have downgraded India's centrifugal sugar output by 3.25 mln tonnes, to 29.9 mln tonnes, raw value. The projected decrease in India's output is partly compensated by significant upward revisions introduced for the EU-27 (+580 thousand tonnes), Brazil (+575 thousand tonnes), Thailand (+200 thousand tonnes) and Cuba (+100 thousand tonnes). On the demand side, only minor revisions have been introduced.

In the meantime, since November the world market has staged an impressive rally. At the end of November, the spot price for raw sugar (the ISA daily price) was 10.01 cents/lb, in mid-February prices touched 14 cents/lb, the highest daily quotation since July 2006. White sugar prices followed a very similar pattern growing from USD289.25/tonne (13.12 cents/lb) at the beginning of December to a 16-month high of USD384.75/tonne (17.45 cents/lb) fixed on 21 February.

How can the price rally contrary to the bearish fundamentals be explained? The ISO believes that since the end of 2007, technical factors have been the key driver of the world market price climb. They include fund activity being further reinforced by the US dollar weakness, which has lifted marginal production costs when expressed in that currency. The large and growing presence of the funds in the market has seemingly added a new and currently pivotal influence on market sentiment and dynamics. As a result, fundamentals and prices became disconnected. It can be noted that it is not the first time in history when technical factors overplay fundamentals. In the past, however, it was only a matter of time for fundamentals to reassert themselves. A surplus of physical sugar remains a surplus and cannot be absorbed by the conviction of institutional investors and money managers that sugar is "undervalued". What is different this time is the far greater level of funds' futures presence on sugar futures markets. Therefore, the period of technical factors disconnecting world market prices from sugar fundamentals can be significantly longer with a considerably higher price volatility.

A summary of the second revision for the world sugar balance in 2007/08 is provided in the table below.

**World Sugar Balance**  
(mln tonnes, raw value)

	2007/08	2006/07	Change	
			in mln t	in %
<b>Production</b>	<b>168.438</b>	<b>166.027</b>	<b>2.411</b>	<b>1.45</b>
<b>Consumption</b>	<b>159.129</b>	<b>154.821</b>	<b>4.308</b>	<b>2.78</b>
<b>Surplus/Deficit</b>	<b>9.309</b>	<b>11.206</b>		
<b>Import demand</b>	<b>46.027</b>	<b>46.045</b>	<b>-0.018</b>	<b>-0.04</b>
<b>Export availability</b>	<b>49.314</b>	<b>46.127</b>	<b>3.187</b>	<b>6.91</b>
<b>End Stocks</b>	<b>73.950</b>	<b>67.928</b>	<b>6.022</b>	<b>8.87</b>
<b>Stocks/Consumption ratio in%</b>	<b>46.47</b>	<b>43.88</b>		

### Currency Movements

Due to the depreciation of the USD against the Brazilian Real (BRL), the Australian Dollar (AUD) and the Euro (EUR), world market price rises have been somewhat cushioned for these countries. By contrast, the South African Rand (ZAR) has depreciated against the USD by 5.8% in the period, and as a result world market prices expressed in this currency have risen by 38.9% since August. Among importers, there has also been some currency appreciation, in particular for the Japanese Yen (JPN) and the Nigerian Naira (NGN), reducing the magnitude of world price rises when expressed in national currency.

### Domestic Markets and Prices

Rises in domestic prices when expressed in USD for Russia and Brazil have largely reflected the weakening USD. Indian prices have risen steadily during the period. In China, domestic prices declined between August and January, but during February they have been rising sharply on the back of snow-related crop damage in Guanxi. In the US, prices have decreased by 6% since August to reach an almost 3-year low.

### Special Focus

This issue of the Special Focus examines one of the fastest growing investors in commodities futures - commodity index funds - and how they are linked to the current bullishness in world sugar futures. There has been recently renewed interest in commodity fund investment as a result of fund managers looking for long term inflation hedging as well as asset diversification away from bonds and stocks. In addition, the growth of commodity index funds is linked to expected higher long-term energy prices, which are in turn affecting most commodities. Moreover, the weighting for sugar within some commodity indices has recently increased as a result of portfolio rebalancing, where assets are reallocated away from commodities that have appreciated in value and into commodities that have underperformed in terms of price. As sugar is perceived to have underperformed in 2007, this has prompted the number of long positions held by funds in raw sugar futures to grow, causing world sugar quotations to rise. The Special Focus also describes the circumstances under which fund investment in sugar futures could retreat over the coming months.

### Fuel Ethanol

Global fuel ethanol production and consumption is forecasted to rise markedly in 2008 to around 66 bln litres. New Energy legislation in the US mandates sharply higher inclusion at 34 bln litres whilst in Brazil continuing robust sales of flex-fuel vehicles drives production and offtake even higher. New and increased inclusion mandates is expected to boost EU consumption to 4.4 bln litres but production could be impacted adversely should cereal prices remain high. India will implement its E10 mandate from October next year, at least doubling fuel ethanol output and consumption. Thailand's government continues to encourage consumption of E10 using consumer price incentives, which could double fuel ethanol consumption. Brazil will remain the key origin of internationally traded ethanol in 2008. The EU will remain as the globe's largest importer - around 1 bln litres - whilst the US is again unlikely to import large volumes. Prices for ethanol have recovered during the past few months in the United States and Brazil and are anticipated to remain firm during 2008.

## Alternative Sweeteners

The ability of US HFCS producers to increase their prices, as well as enjoying rising byproduct values, had enabled the industry to cope with a situation of sharply higher corn prices, particularly over the past 6 months, and will ensure reasonable margins in much of 2008.

Stevia and related sweeteners face a brighter future after Coca-Cola and Cargill teamed up to market a version of the sweetener to be called Rebiana. Malaysia-based company PureCircle has a proprietary process technology for the extraction of high-purity extract Rebaudioside-A and plans to expand production capacity three-fold over the next two years. The company has also secured an extension to its agreement with Cargill to supply its stevia-derived sweetener until mid-2010.

## Molasses

Molasses prices have risen since late December after weakening for much of 2007. The rise is mainly driven by buoyant grains markets which have acted to boost demand for molasses from the livestock feed and fermentation sectors. Fundamentally, the molasses market is anticipated to remain well supplied this year, with continuing high exports likely from India.

## WTO

WTO Members have commenced another push to conclude an accord in the troubled Doha Round talks. However, they face difficulties over how to agree a framework 'modalities' deal on agriculture (and industrial goods trade) by the end of March or April, while other issues in the negotiations remain unresolved.

## Regional Trade Agreements

The forum of the Caribbean ACP states (CARIFORUM) have gained additional access to the EU sugar market for 60 thousand tonnes as part of the Economic Partnership Agreements (EPAs) signed with the EU.