

The Sugaronline Sugar and Ethanol Conference

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The World Sugar Surplus – How Big and Where Is It Going To Go?

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ISO – International Sugar Organization

The only worldwide operating intergovernmental organization for sugar, sweeteners and other related products.

ISO membership – 81 countries including Australia, Brazil, Colombia, Cuba, Egypt, the EU, Guatemala, India, Iran, Mexico, Pakistan, Russia, South Africa, Sudan, Thailand and UAE representing 83% of world sugar production and 65% of consumption, 94% of world exports and 39% of world imports

Main objectives:

to ensure enhanced international co-operation in sugar and related products

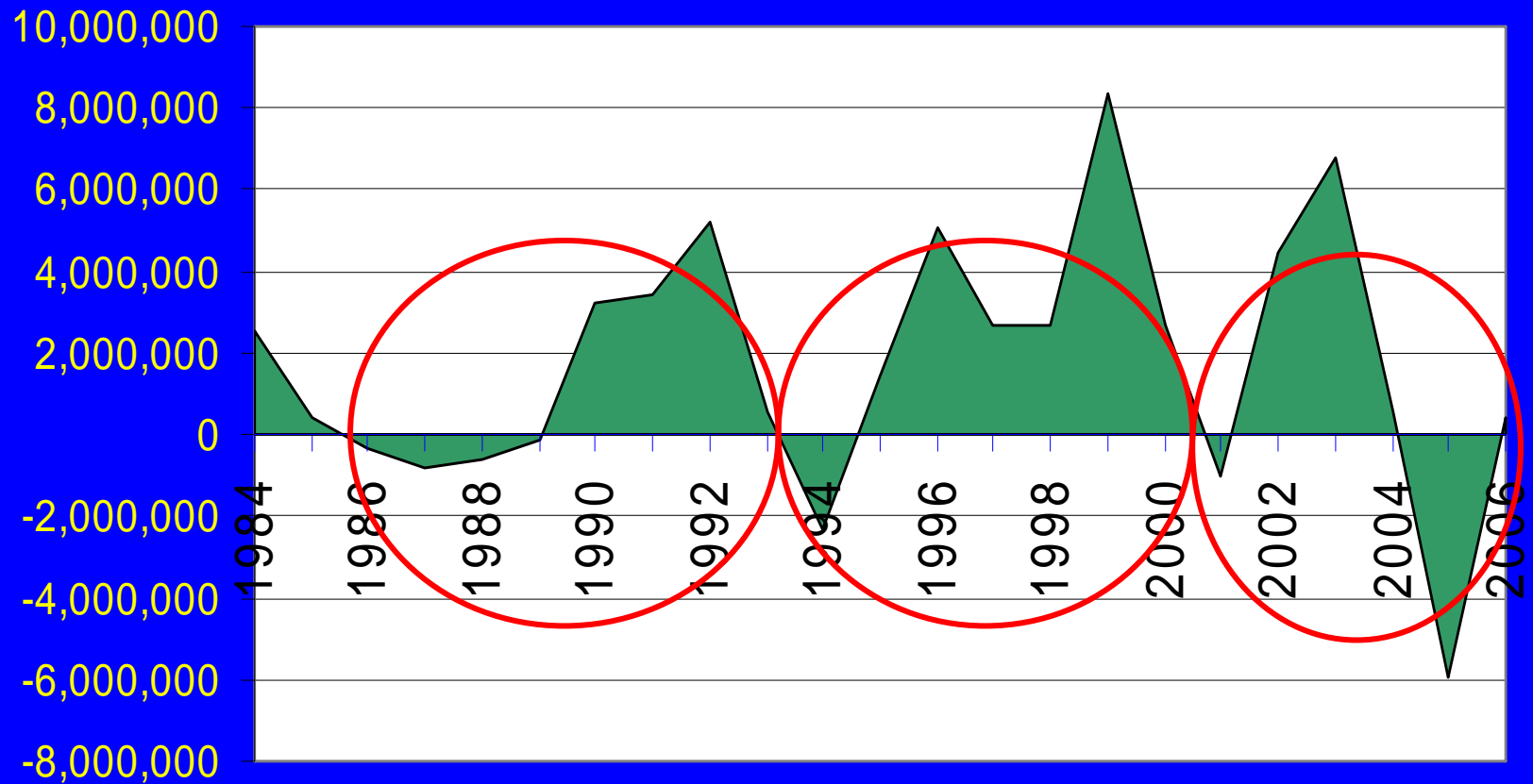
to provide a forum for intergovernmental consultations on sugar

to facilitate trade by collecting and providing information on world sugar market

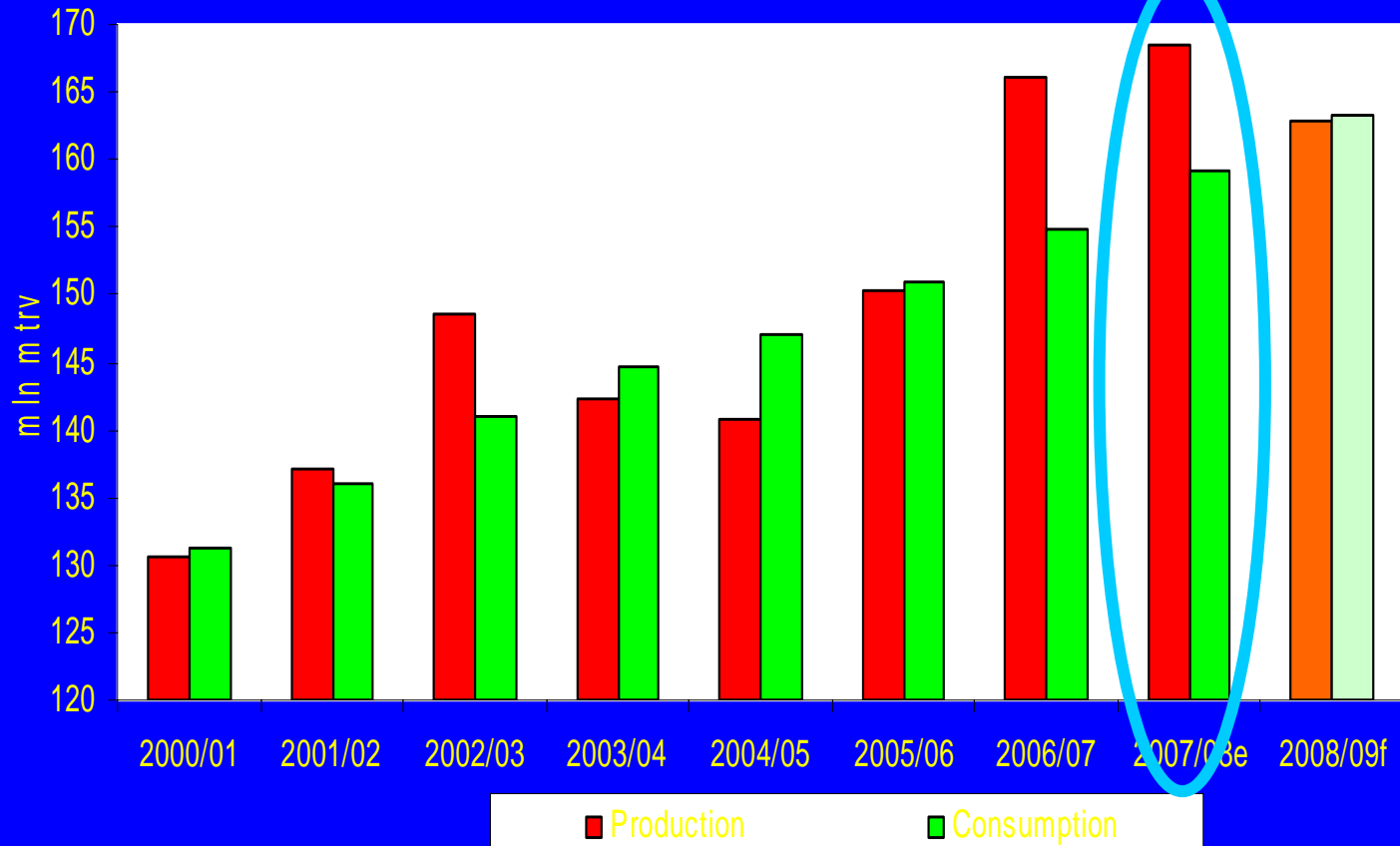
To provide an early warning system regarding newly emerging challenges and opportunities in the areas of sugar policy, trade matters and diversification



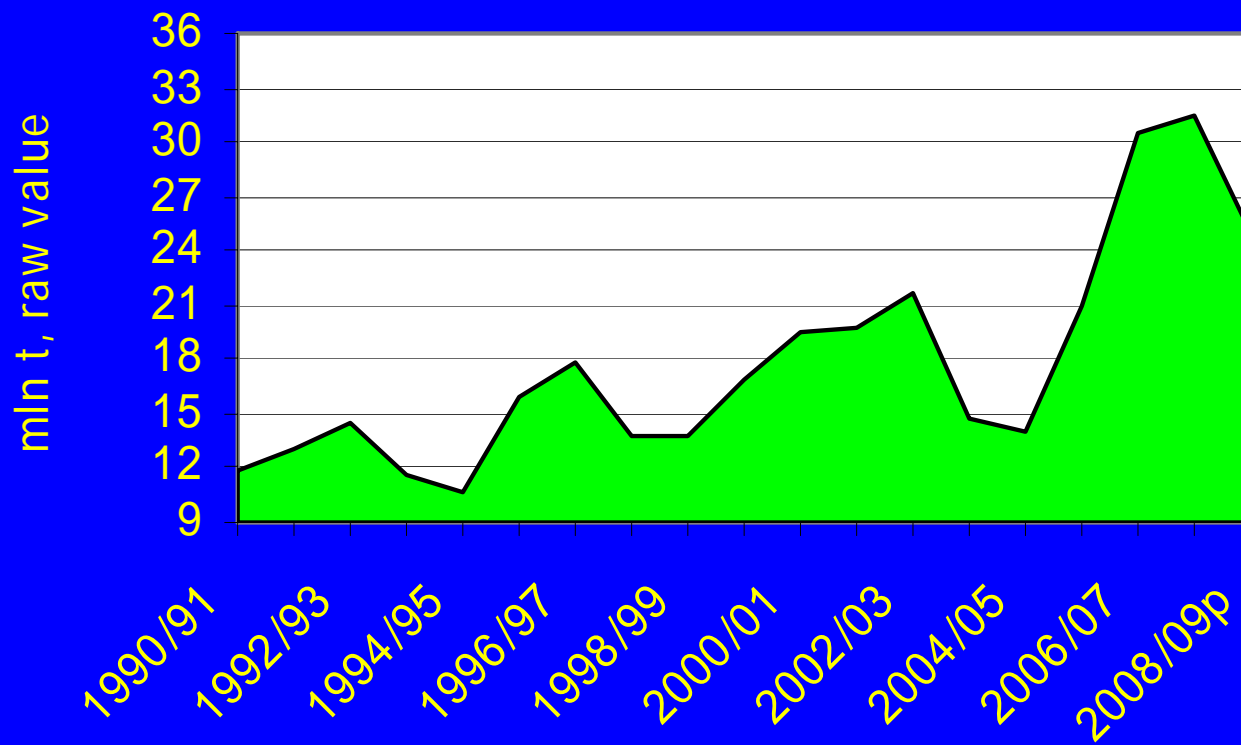
Global Supplus/Deficicit



World Sugar Production and Consumption (October/September)

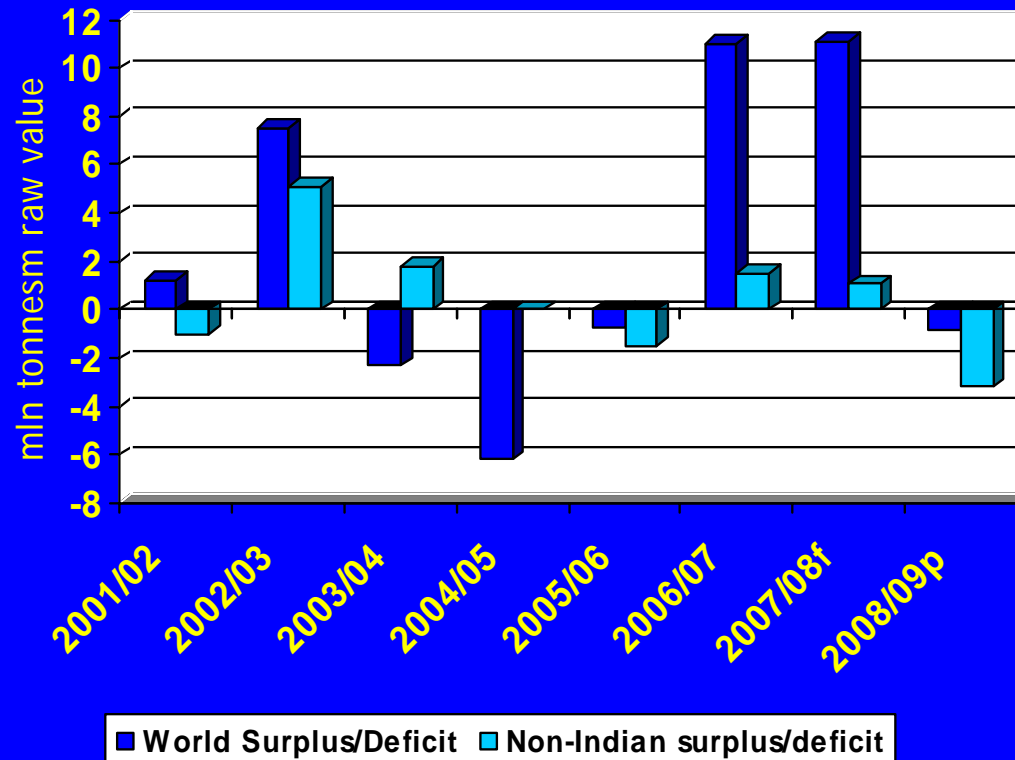


Sugar Production in India

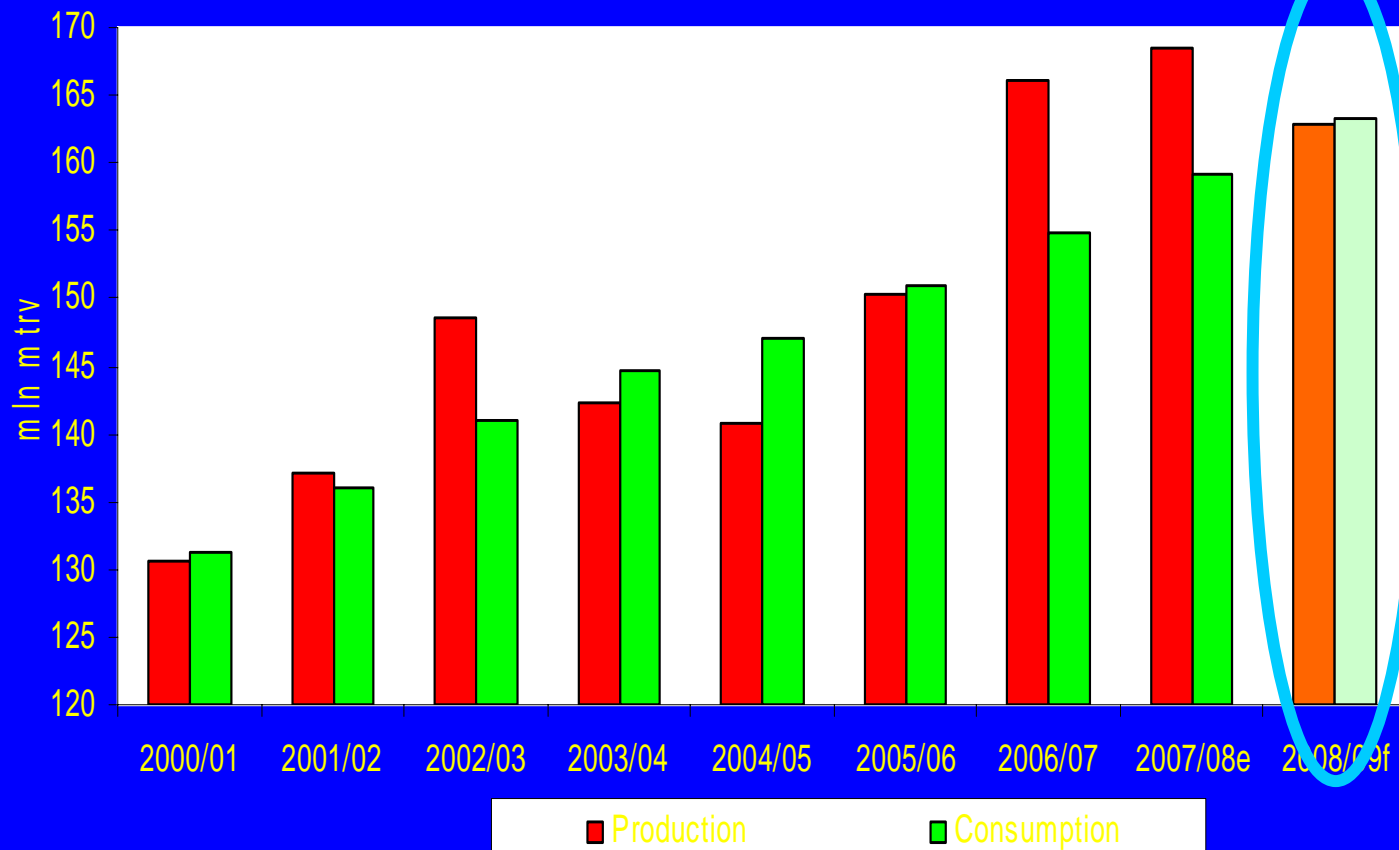




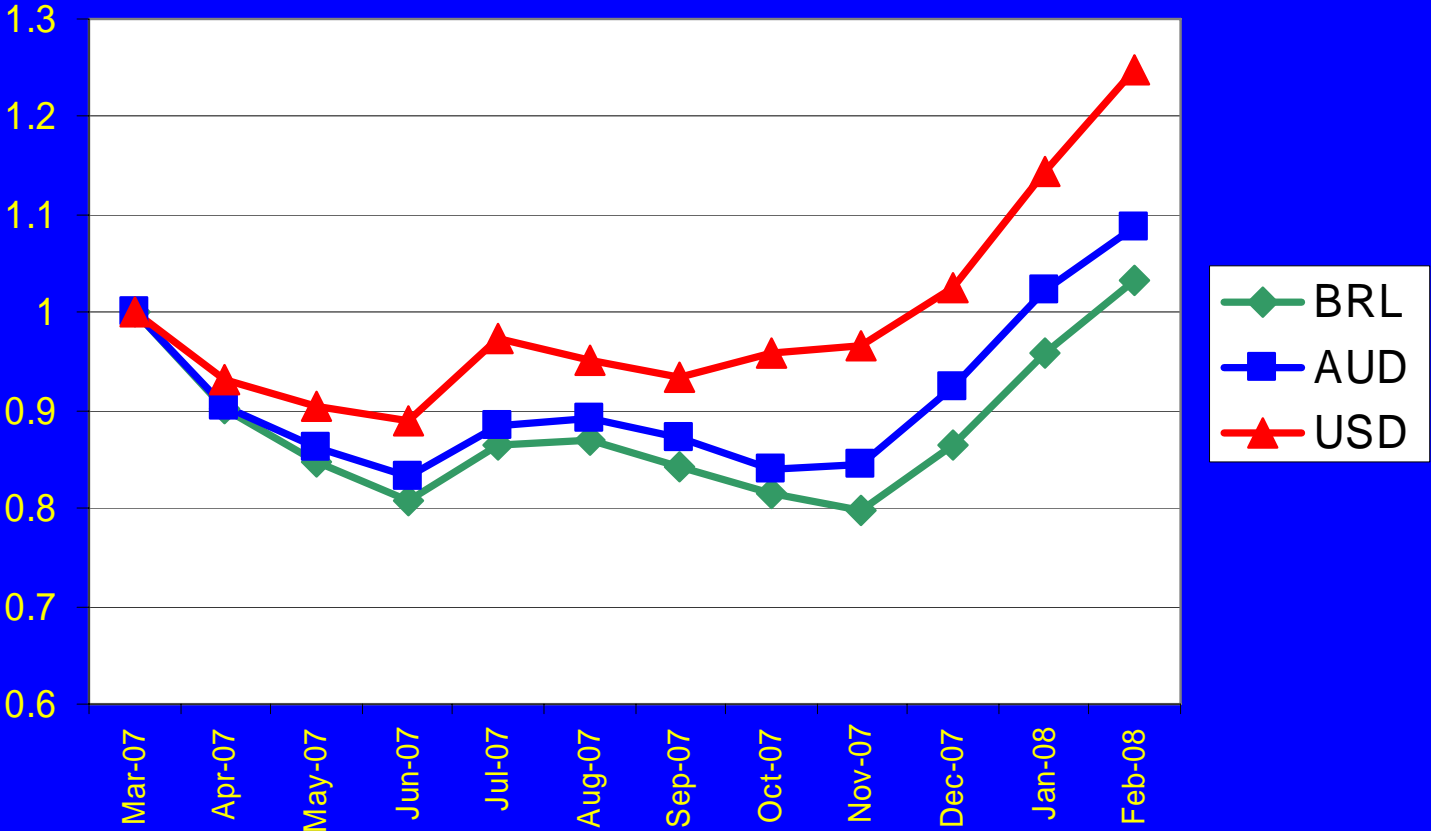
World surplus/deficit, 2001/02-2008/09



World Sugar Production and Consumption (October/September)

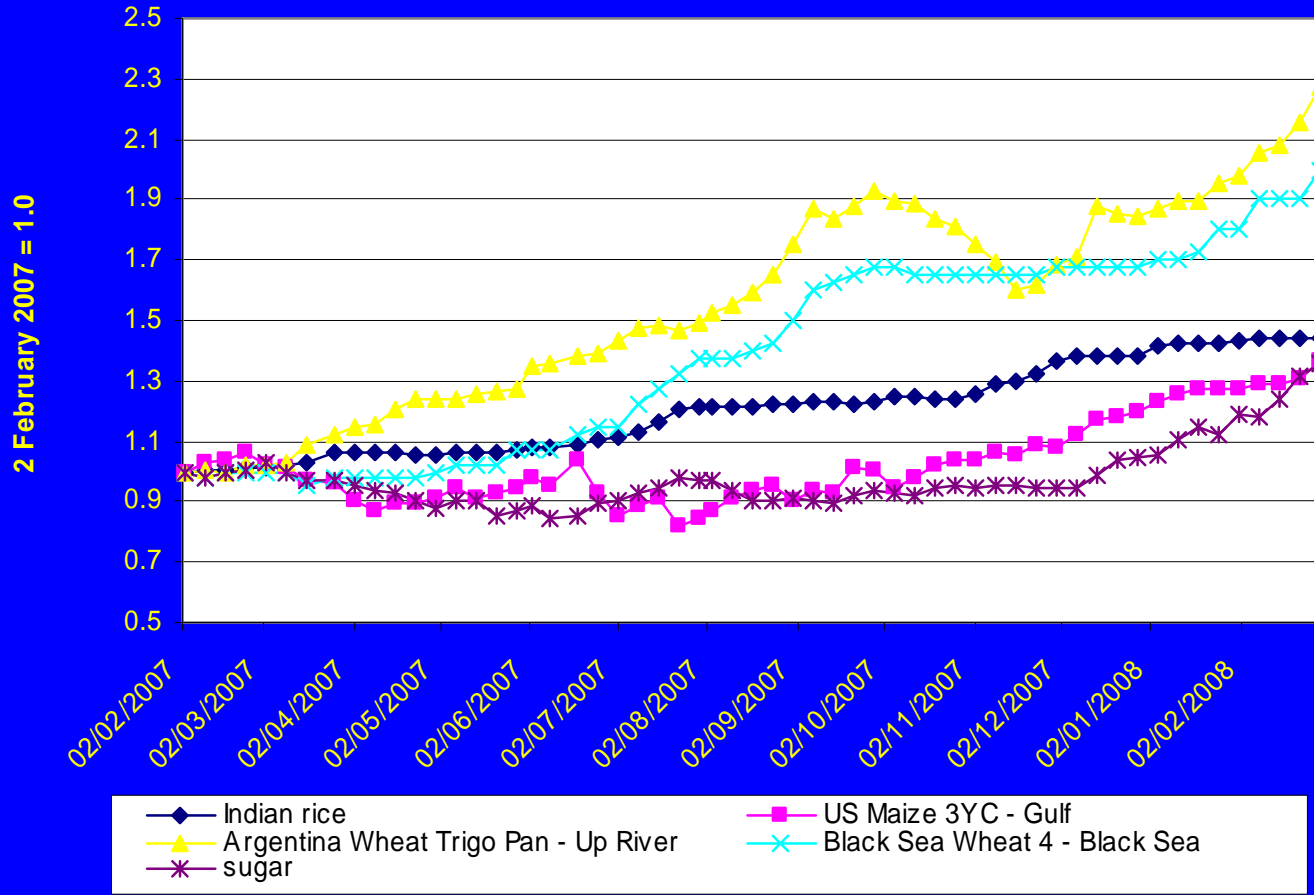


World Market Spot Prices February 2007=1.0



ISO

Export prices for selected grains and ISA daily price (February 2007-February 2008)



The (sugar) market is in new territory... What is driving the market is the relative strength of ethanol prices – FIMAT USA Inc., 27 September 2005

If oil stays north of \$60 per barrel , then you have a diversion of sugar into ethanol. Sugar looks great – Liberty Trading Group, Florida, 5 October 2005

Sugar is seen as an energy source, and its price affected by the large increase in flex-fuel car use in Brazil – Barclays capital, 20 October 2005

We are in a new trading environment (in sugar) with strength in energy and other commodities – J&F Commodities, 15 December 2005

Sugar is increasingly seen as an energy market ... - Man Financial, 25 January 2006

Sugar keeps moving in tandem with oil prices – Sonnen and Co. Inc, 18 April 2006

Sugar will benefit from increased demand to make ethanol as an alternative motor fuel in Brazil – Barclays Capital, 30 May 2006

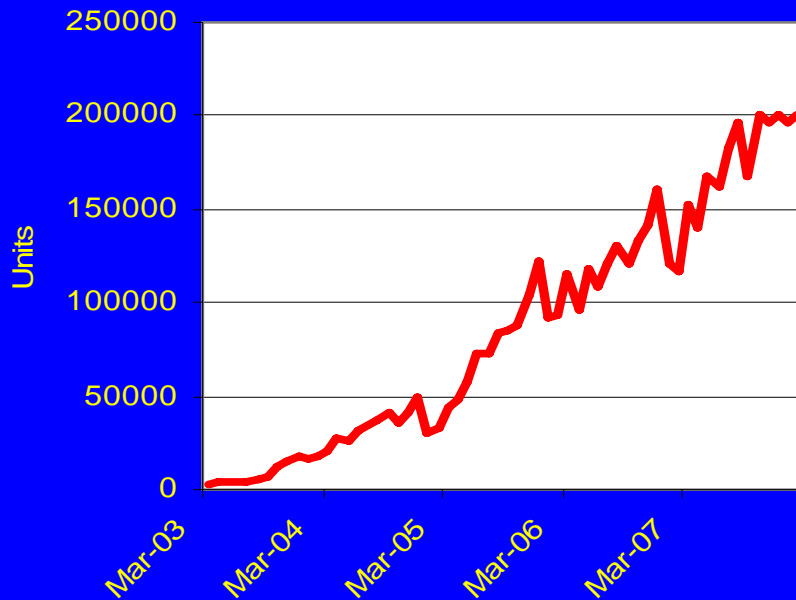
The ethanol angle has given a strong boost to (sugar) prices – Barclays Capital, 19 June 2006

Food companies ... could face higher commodity costs over the long term as rising demand for biofuels pushes up prices for raw materials such as wheat, corn and sugar – Goldman Sachs, 20 July 2006

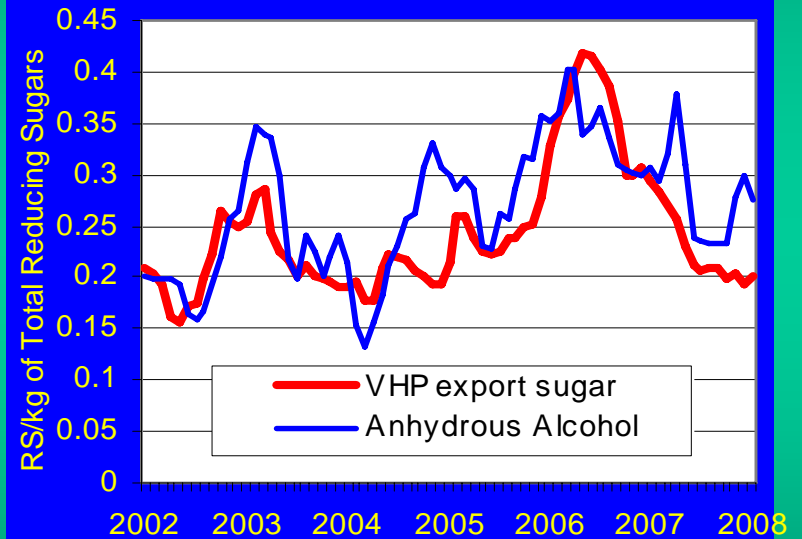


Brazil

Sales of ethanol-fueled and flexifuel vehicles in Brazil

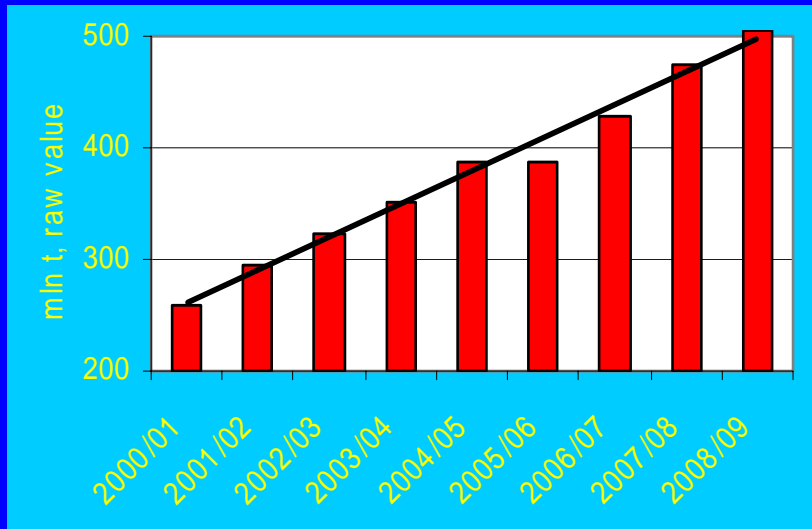


Brazil: Value of cane for different uses

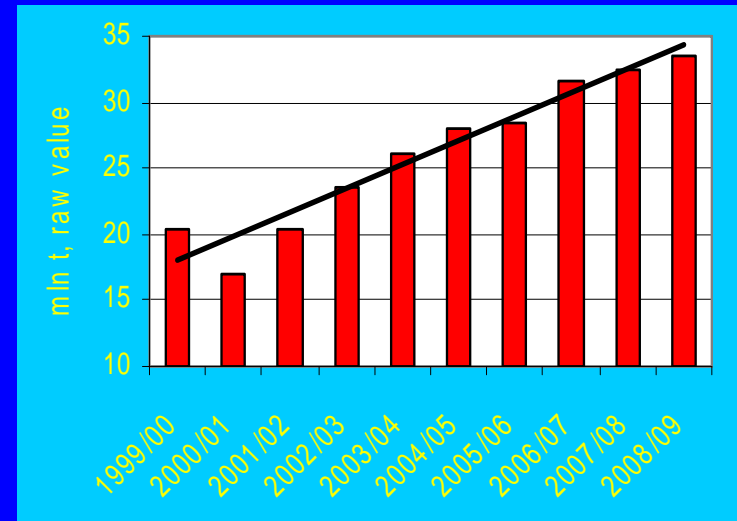


Brazil

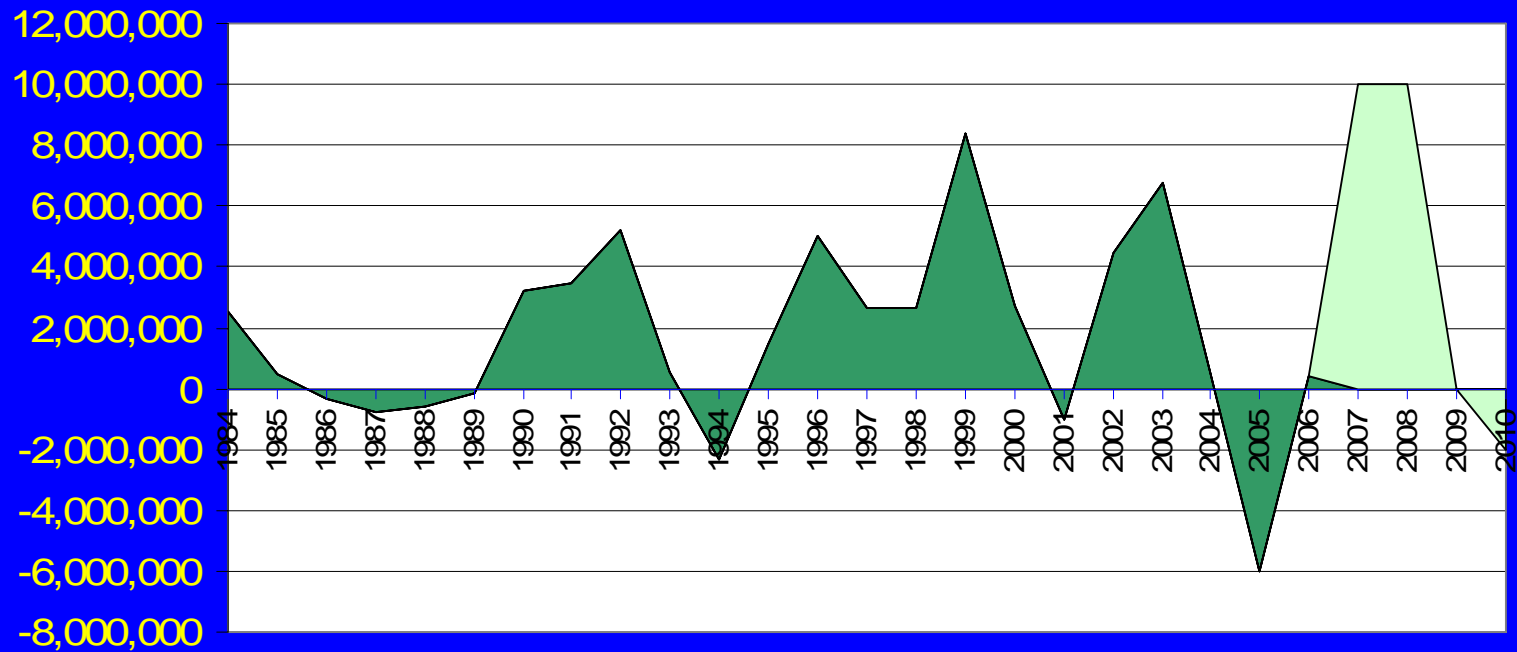
Cane production



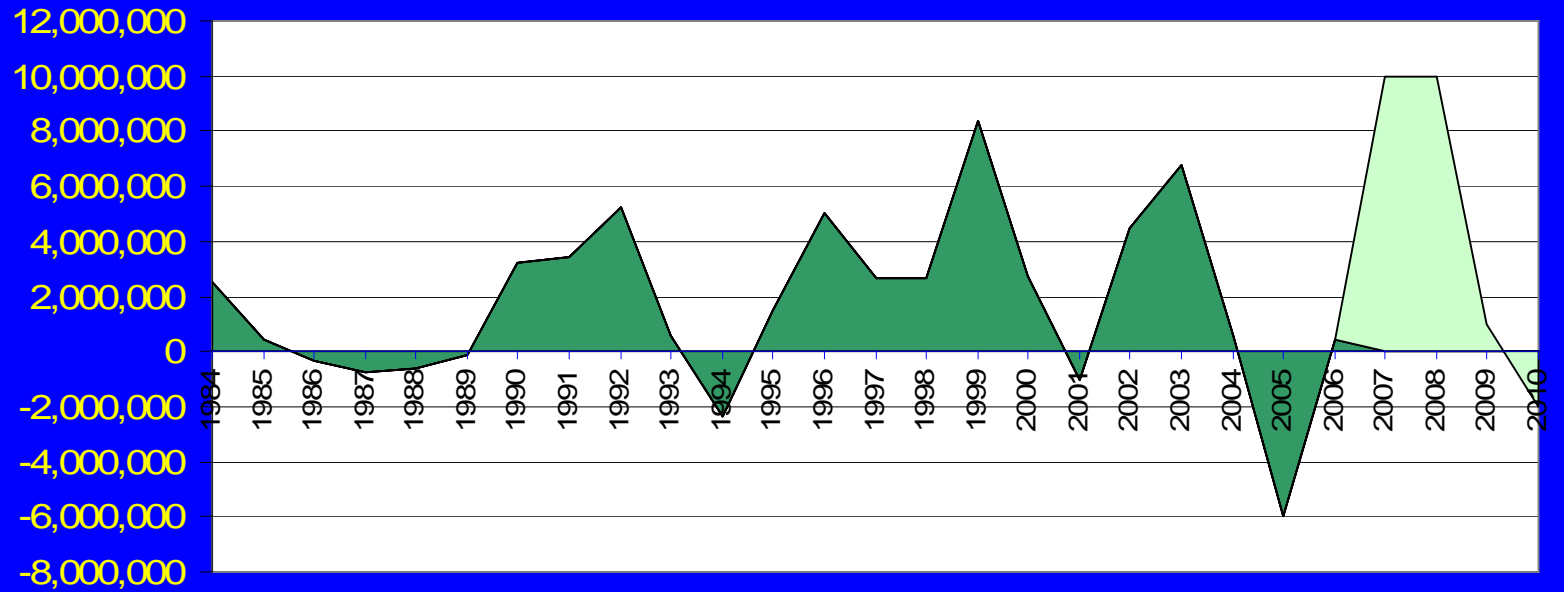
Sugar production



Global Supplus/Defrcicit



Global Supplus/Defrcit



NEW WORLD ORDER FOR SUGAR

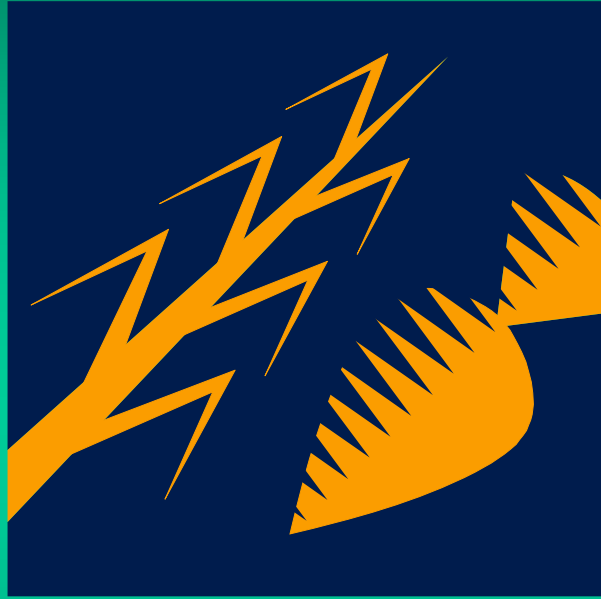
Globalization finally is an economic reality in sugar world

With profound changes in the global economy and investment industry, one involved in sugar production, use or trade cannot afford to ignore the non-sugar factors:

- *the outlook for oil and other hard and soft commodities,*
- *exchange rate fluctuations*
- *developments in ethanol production and use*
- *the upsurge in renewable energy programmes*
- *growing criticism over use of food for energy*
- *macroeconomic issues*
- *the general outlook for different classes of investment assets*
- *funds activity*

...





ISO

The World Sugar Surplus – How Big and Where Is It Going To Go?

[S]

[S]

Any commodity cannot be in surplus or in deficit for ever. Sugar is not that different. [S]

Historical evidences suggest that there is a well readable cycle of, say, 6 to 8 years during which the global sugar pendant move from deficit to surplus and then back to deficit.

So, in what part of the cycle are we? [S]

This season the world sugar economy is facing the second consecutive season of a massive gap between world production and consumption. According to the latest ISO estimates for the period from October 2007 to September 2008 world production is expected to be 9.3 mln tonnes higher than world consumption. Also of importance, world export availability is expected to exceed import demand by 3.3 mln tonnes. Currently we forecast ending stocks to grow by 6.0 mln tonnes, but if the unsold sugar has to be added (exporting countries are not likely to find a home for all of their surplus sugar and will be forced to accumulate stocks), the total rise of stocks by the end of the season can be as high as 9.3 mln tonnes. Hence, by the end of the season, the stocks/consumption ratio can be as high as 48.5% as against 43.9% in 2006/07 and 37.7% in 2005/06.

Before moving to future prospects, it is worth to look first at how the world sugar economy has arrived to this huge surplus. Here the special role of India cannot be overestimated.

A sharp fall in sugar production in the 2003/04 season forced India to rejoin the importers' camp. [S]

After six consecutive years of relentless growth – domestic production grew from 13.9 mln tonnes, raw value in 1997/98 to 21.7 mln tonnes in 2002/03 – sugar output collapsed to 14.7 mln tonnes in 2003/04, mainly as a result of unfavourable weather, and dropped further to 13.8 mln tonnes, raw value, in the following season. Cane production was affected by acute drought conditions in major cane producing areas of Maharashtra, Karnataka, and Gujarat. Maharashtra and parts of Karnataka also experienced a severe infestation of white woolly aphids (a sucking pest), which affects the yields and sugar recovery. In 2005/06, however, the pendant of the notorious Indian sugar cycle changed the directions. Production recovered to 20.9 mln tonnes and improved to 30.6 mln tonnes last season.

What is important here – depending on the size of cane crop, India can not only swing from the exporters' camp to that of importers and back but also can single-handedly change the statistical character of the world sugar balance for a given season.

It is worth to remind that the fall in Indian sugar output was without doubt the most constructive fundamental factor for world market values in the early years of this decade. [S]

Thus, production shortfalls in India alone saved the world market in 2003/04 from an overproduction crisis, after the disastrous season of 2002/03, when nearly 8 mln tonnes of surplus sugar were stocked and world market values dived below 6 cents/lb. In order to illustrate the special role of India, let us compare the world surplus/deficit dynamics with and without Indian stats. [S] The difference could not be more striking. If India's supply/demand figures were omitted last two seasons' massive surplus of 11.2 and

9.3 mln tonnes would be replaced by a moderate surplus not exceeding 1.5 mln tonnes. By the way, it would similarly mitigate a large global deficit of 2004/05.

Now when we have established from where the global surplus arrived, let us think about where and when it may go.

From the point of view of pure sugar fundamentals the situation does not look too promising. Our first tentative forecast for 2008/09 suggests that global supply and demand might be in balance. **[S]** For the time being our working assumptions are that India's output will reduce to 25 mln tonnes, raw value, production is also expected to decline in the EU and China but still grow in Brazil.

One may hope that bad weather may bring a massive production shortfall, in particular, in Asia. Indeed, next season's Chinese sugar output may be severely affected by recent frosts in cane growing provinces. The danger is that, as a result of rocketing domestic prices, Chinese sugar consumption may not grow at a rate currently forecasted and all the growth in sweeteners demand will again covered by alternative sweeteners and not by sugar. So, the net-result may not be as great.

India may have bad monsoons with an obvious result for sugar output. However, at this stage of the year it is hardly possible to predict this sort of weather calamities with a decent degree of accuracy. Talking about the rest of Asia, even if the coming 12 months bring dry weather, it will affect only 2009/10 crop as low cane production is likely to be compensated by higher sugar yields.

At a first glance, the recent rise in world market sugar prices also do not augur well for so needed production response in order to mitigate the accumulated surplus. Stronger prices may be

expected to encourage a further production growth. The question is whether the current US dollar denominated prices are really high in real terms. [S]

Not in the case of Brazil, the world's largest sugar producer and exporter. Thus from March 2007 to February 2008 world market prices in USD rose by about 25%, but when expressed in BRL, the growth was as little as 3.3%. The situation is only slightly better when world market prices are expressed in Australian dollar. If you look at the situation during last 36 rather than 12 months the picture will be even more striking. Thus, while by early March world sugar prices in dollar terms had improved by 57% compared to where it was at the start of 2005, when converted in Brazilian real they has actually weakened by 2%.

Another aspect of the price signal enigma is the comparative profitability of sugar against alternative crops. The detailed analysis of sugar crop competitiveness is a rather long although feasible exercise. As a simplistic version, one can look at the relative strength of market prices for different agricultural products. [S]

Throughout 2007 sugar prices in relative terms remained significantly lower than those for grain or corn. Despite a recent impressive growth in the sugar futures, only in February the sugar price growth rate catch up with that of US Gulf corn export prices, but it still remains significantly lower than relative increases in export prices for rice and wheat. In other words, the price signals for sugar crop growers are not that strong and it might be premature expect a massive increase in areas and agricultural inputs into sugar cane or beet cultivation at the expense of competing crops. Just one illustration – in Russia domestic sugar prices generally follow the world market quotations and beet sugar processing may seem as an attractive option taking into account the recent improvement in sugar futures. In reality, however, there

are growing concerns that this season farmers will switch land from sugar beet to much more attractive grain and oilseed crops.

Talking today about sugar one cannot omit the ethanol issue. Energy security and climate change are two of the most significant challenges confronting humanity in the new millennium. Against this backdrop it cannot come as a surprise that over the past few years there has been a growing interest in biofuel production. Sugar cane is one of if not the best feedstock for ethanol production. As a result more and more often sugar is considered by market players as energy as well as food commodity. I may only remind how the sugar-ethanol issue were treated in 2005 and 2006 during the previous sugar price boomette. [S]

We know, however, that the ethanol/sugar bubble busted in mid-2006.

Nevertheless, can ethanol be a saviour for an oversupplied sugar market? In 2005 and the first half of 2006, world sugar supply was seen inextricably linked to crude oil prices via ethanol. Then the weakness in sugar prices, despite continuing high energy prices, raised questions over how strong the interface was. Because the world sugar market was and still is again in surplus, energy and sugar prices were effectively de-linked. Fledgling fuel ethanol programmes around the world are expected to continue using either molasses in preference to cane juice, or use starch feedstocks including grains and cavassa. In general terms, the ethanol-sugar interface still remains centred in Brazil. I do not like to waist your time and repeat the arguments we have already heard in the course of the conference. [S] We in the ISO believe that Brazilian cane processing sector can still increase cane production in order to cover fast growing demand for fuel ethanol in both domestic and international markets. [S] Additional availability of cane will also allow increase further sugar production,

in particular, if world sugar prices remain relatively attractive in terms of Brazilian real. In a longer run, by 2015 cane area may double as against 2006. It has nothing to do with ecological sensitive areas in Amazonia. It is neither a problem of competition for land. The most of the expansion will have place in so called cerrados, some sort of flat savana type plains the Central Western part of Brazil. This is an arable land but not currently used for cultivation of any crops. Brazil currently uses about 60 mln ha or less than 10% of its territory.

Putting all things together, what will be the updated picture I started my presentation with? It can look something like this [S] or like that [S].

The actual volume of production will depending on weather in key growing areas and India's monsoons, in particular, as well as the ratio in cane use for ethanol and sugar in Brazil. In is worth remember that a just 1% change in sugar ethanol ratio there means about 700 thousand tonnes of sugar in or out from the world sugar supply. In any case it is much too earlier to attempt to provide a real professionally made forecast with a reasonable level of probability. I do not like to supply you with eye catching headlines today, although cynically speaking, the shelf live of such projections in fast moving times is short and market players will most probably quickly forget what this or that analyst said few weeks ago.

What is clear is that sugar cycle continues and we are approaching the deficit phase of the cycle.

What is also clear is that, gone are the days when you only need to know about sugar fundamentals to develop a reasonable accurate outlook for the futures and physical sugar markets. [S]

With revolutionary changes in the global economy and investment industry, one involved in sugar production, use or trade cannot afford to ignore the non-sugar factors, including interrelated macro factors which are currently setting the pace and direction for sugar market. In other words, globalization of the world economy, a fashionable political slogan for years, finally is an economic reality in sugar world. No serious analysis of sugar market situation is currently possible without addressing the myriad of issues including the outlook for oil and other hard and soft commodities, exchange rate fluctuations, developments in ethanol production and use, the upsurge in renewable energy programmes and growing criticism over use of food for energy, macroeconomic issues, the general outlook for different classes of investment assets, funds activity, and so on. To some extent, the question I was asked to answer – how big is sugar surplus and when and where it will go – does not look any longer that important in terms of understanding the future directions of world prices. Fundamentals and world prices are disconnected. It is not the first time in history when pure sugar fundamentals are overplayed by non-sugar factors. In the past, it was only a matter of time for fundamentals to reassert themselves. What is different today is the far greater globalization of world sugar, that even allow us to talk about the new world order for sugar taking into account the myriad of interrelated non-sugar factors, which are expected to continue driving world market sugar prices.