

The Sugar Situation

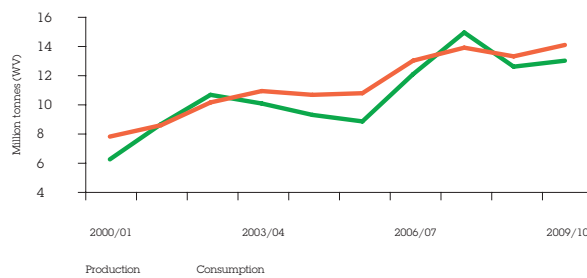
Focus

Another Deficit Year Looms – North Crops Kick-Off Play

On the approach to the new, 'old-fashioned' Oct/Sep, sugar season, market focus has largely been on developments in India and Brazil. While accepting the central role our two key protagonists will play in shaping 2009/10, developments elsewhere deserve scrutiny, partly because regional implications are more important than ever within the sugar sector, but also because regional signals have always provided a useful barometer of the wider market, particularly during times of change.

China faltering – After seeing sugar production drop 19% in 2008/09 to 12.4m tonnes, China is again facing the prospect of another disappointing crop. The main cane growing province of Guangxi which accounts for 60% of total Chinese sugar production saw a 6% drop in planted area; a situation replicated in other cane growing areas and to a greater extent in the northern beet producing regions. Consequently, overall production is likely to fall below 12m tonnes. Economic slow down, high sugar prices and low starch prices, have eased growth in local demand however, which along with good stock levels should provide some buffer and suppress what could otherwise have been a very substantial import requirement this coming year.

China S&D Developments



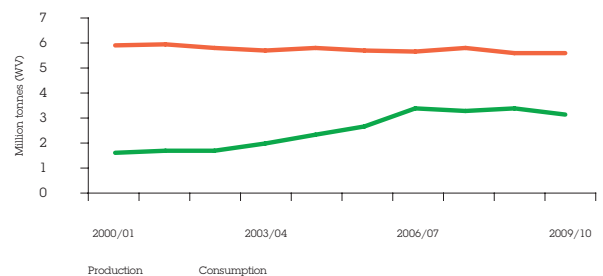
Recovery, elsewhere in Asia – To the south in Pakistan, the monsoon season is said to be developing relatively well, with the country expected to present a small recovery in the coming crop, although it is likely to be little more than 4m tonnes, well below the 4.8m tonnes produced in 2007/08. Pakistan however has shown a great capacity to respond to price signals in the past, so this year's upward trend should only be the start. While the monsoon in the north would appear to be satisfactory, the outlook for the Indian monsoon has clearly worsened in recent weeks, with the erratic nature of the rains once again proving more worrying than outright precipitation levels. Consequently, official production estimates continue to be trimmed, with expectations currently ranging from 16-17m tonnes. In Thailand, favourable weather and increased area, is expected to pave the way for sugar production to reach 7.6m tonnes, after the disappointing 7.1m tonnes seen in 2008/09.

Furthermore, improved use of farm inputs should mean that cane yields are sustained longer across the season than was the case this year. Therefore the Thai tradable surplus is

expected to return to above 5m tonnes, helping to reduce the regional shortage.

Europe, a good summer for beet – Beet test results for the imminent Russian campaign indicate that while yields are unlikely to match the exceptional levels seen in 2008, they should better the three-year average. While there has been some suggestion of damage to fields from some unfavourable weather over the summer and low fertilizer use, the overall situation is still favourable for a crop ranging between 2.8-3m tonnes given that area has remained unchanged. Should this production figure eventuate, imports are expected to rise to around 2.8m tonnes more in line with historical levels than the very low imports witnessed in 2008/09. Initial beet tests in the EU are pointing to record yields across the continent. While soaring production will not impact on the internal balance, given production quotas, it can be expected that European producers will return to the world export market with as much enthusiasm as 'Brussels' (and the WTO) allows them; currently, allowance to effectively export 950k tonnes in the coming year has been granted, with little reason to see this export limit not being filled.

Russia S&D Developments



North America, tight, but better crops in prospect

– Indications from the USDA suggest better than expected cane and beet crops with potential further upward revision pending a favourable autumn weather. An increase in beet area and better yields, as well as positive prospects for cane production in Florida offset the reduction in cane area seen in Louisiana. Overall US sugar output is expected to rise 10% to 6.9m tonnes; at least partially offsetting the reduction in imports from Mexico expected, given the tight supply situation south of the border, but possibly not enough to counter strong demand and tight stocks. ■

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Another Deficit Year Looms – North Crops Kick-Off Play

Factors to Watch

- ▶ China: Switch to alternative sweeteners and general demand destruction due to high prices.
- ▶ EU: Very good crop potential should mean exports revert close to the WTO limit; given the political environment however, this is by no means certain.
- ▶ India: Weather developments over the remainder of the monsoon period. High sugar prices could divert sugar cane from traditional jaggery/ghur production to centrifugal sugar production.
- ▶ Russia: Autumn weather. Demand destruction due to high prices and economic slow-down.
- ▶ USA: Growth in sugar demand due to perceived health benefits over HFCS; extent to which this will impact on the tight market balance is uncertain. Implications of political decisions on import quota management. Analyst versus analyst from the respective lobby camps.
- ▶ Development of El Niño, implications mainly for Southern crops, but also impacting on the north, as is apparently the case with the Indian monsoon. ■

Futures Market

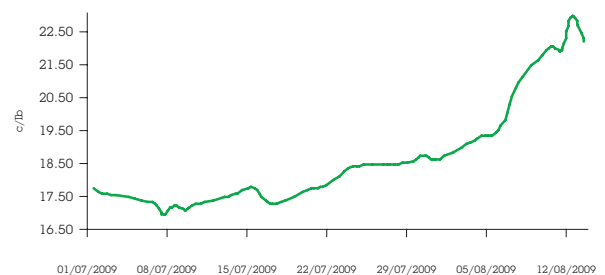
There is probably not a person in the world who does not know that the sugar market is on fire at the moment. If you pick up any newspaper you will read an article on sugar scorching to 28 year highs.

Many thought the 2006 peak would take a while to be broken but it was blown out of the water and the market raced on northwards. The primary driver has been the disappointing monsoon in India, potentially reducing the size of their 2009/10 crop starting in October. This has triggered a surge of speculative money which amid very limited selling has almost led to a vacuum forming on the upside of the market. The irony is that there is no physical sugar deficit at the moment (just look at the New York and London sugar market front month switches and physical values), but as usual the futures market is about anticipation, with the focus being on Q1 2010 and beyond.

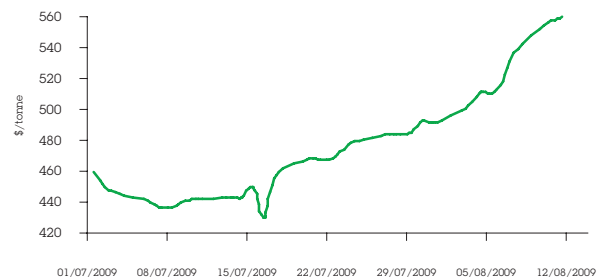
The chart to the right shows the rapid rise in the No.11 sugar market over the last five weeks. What the chart fails to highlight is the huge intra-day ranges that have been seen, with V9 seeing a daily range of 180 points and HO 186 points on Aug 10. This said, this is nothing compared to the 1,000 point range seen on Nov. 12 1974!

The size and speed of the rally has been impressive. Initially the market rose for nine straight days before dropping on the last day of June (profit taking) before storming higher for the next six days rising 339 points (of which 119 were seen on Aug 10 alone). Limited selling, as well as rumours of producer defaults leading to some short covering, fuelled the market higher to 22.97c/lb. Since then the market has stalled with a drop seen on Aug 13 to 22.21c/lb. A breather was to be expected, the question is now whether a correction will be seen given that import parities remain firmly shut for many key markets. Meanwhile, the spreads remain fascinating too. The VH has widened to -150 as Brazil remains long sugar and the anticipation that some trade houses will deliver sugar so as to remove their short futures from the pressures of margin calls grow. ■

ICE Raw Sugar Futures



Euronext White Sugar Futures



White Premium





Futures Market/continued

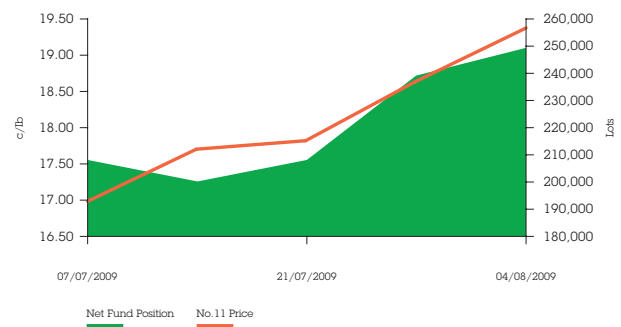
Down the board, both HK and KN have both ballooned out to +120 (and much more intra-day, highlighting the view that the market will be a deficit. One major question that remains to be answered is how much demand will be lost as prices rise? The whole point of rising prices is to bring the market into balance via curtailing demand. Where is this tipping point or have we already passed it?

London whites prices also rose strongly with the V9 reaching \$577 by Aug 13. As with New York, the VZ spread has widened to -\$20.50 as a sizeable quantity of Brazilian and more importantly a cargo or two of Argentinean sugar looms large on the tape. With physical offtake very quiet and the market seemingly more interested in low quality whites, the attraction of taking sugar from the tape is not great – despite the headlines of sugar shortages!

White Premium – The WP chart is skewed greatly by the London Aug expiry mid-month. Since then the spot WP of VV has traded in a steady range of \$75-\$85 a tonne. Rumours of a Mexico import quota did spark a rally in the WP but the market soon absorbed the news and the lack of clarity on when it will occur caused the spark to soon fade.

Commitment of Traders – The net futures only fund position, which is the net of the Non-Commercial and the Non-Reportable positions stood at 249,405 lots long by Aug 4 compared to 207,982 lots at the start of July. This surge in longs helps explain why the market has rocketed higher. ■

Net Fund Position vs No.11 Price – Jul/Aug 09

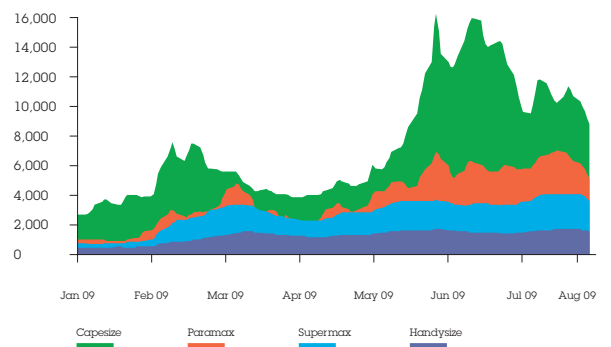


Freight Market and Forex

Freight – Global freight continues to largely track China’s fortunes and in particular its appetite for raw materials.

High inventory levels, particularly for iron ore and depressed industry activity continue to suggest that any rebound in freight rates will be limited for the time being. This is further compounded by the rising number of new ships expected to hit the market in the coming months despite indications of vessel cancellations and lay-ups. Panamax rates were also under pressure with slow demand from South America, both for minerals and grains. This weakness is expected to transfer to the Pacific region once cargoes are discharged and looking for their next trip. Supramax vessels were in slightly better shape with sugar again quoted as a supporting factor from South Brazil.

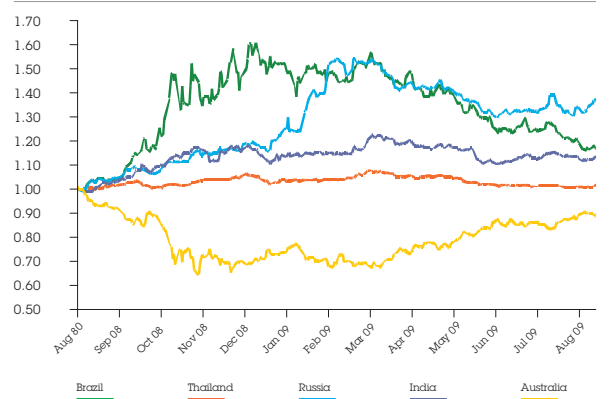
Baltic Exchange Freight Indices



Forex – The U.S. Federal Reserve said on Wednesday that the economy was showing signs of levelling out.

The Central Bank also kept its benchmark short-term interest rate steady and indicated that it would probably stay there for an extended period to guide the way to recovery. In sugar currencies, the Brazilian Real and the Mexican Peso strengthened against the US dollar, ranging between 1.81–1.99 and 12.9–13.7 respectively. The Thailand Baht has been more stable, trading between 33.9–34.1 over the month, with the Indian Rupee consolidating between 47.3–48.9. The Russian Rouble weakened to 32.75 towards the end of July. ■

Forex – Index for Key Sugar Currencies (Base – Aug 08 = 100)





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Fundamentals

AMERICAS

Brazil – Rain showers seen in July have negatively impacted on the progress of the Centre South harvest, as demonstrated by the latest UNICA figures as of August 1st, with the rapid advancement over last year slowing. Total cane crush totalled 246.6m tonnes, up 15% compared with the same period of 2008/09. Sugar content (TRS) has however been particularly affected and experienced a significant drop. Cumulatively TRS now stands at 127.5 kg/tonne of cane, down 3.4 kg year on year. To date 42.7% of total cane has been allocated to sugar versus 42.2% in the previous fortnight and 40.1% a year ago. Sugar output now totals 12.8m tonnes, or 19% (or 2.1m tonnes) up on 2008. Ethanol production presented a more modest increase of 7% to 10.5m CBM. According to the ESALQ price index, domestic sugar prices have been following the global upward trend, trading at nearly R\$43/bag against R\$29/bag a year ago. Ethanol prices however have been oscillating over the last month, seemingly tracking the changeable weather outlook. Prices overall in July averaged higher than those in June and during the first week of August anhydrous and hydrous ethanol were at an average of R\$801/CBM and R\$712/CBM, respectively.

Mexico – Strong exports north of the border, combined with this year's disappointing crop, has left the Mexican inter-crop period tight; prompting the Government to open a new import quota for 393,000 tonnes of refined sugar to dampen rising prices. This tonnage is for the Aug/Sep period with 39,300 tonnes being open to Nicaragua duty-free, with the remaining 356,700 tonnes open to the world market subject to an import duty of US\$36/tonne (versus previous US\$360/tonne).

ASIA

India – An extension of duty-free sugar imports for both whites (up to Nov 30 subject to a cap of 1m tonnes) and raws (until Mar 31, without re-export obligations) has been confirmed, after weeks of political machinations. The Ministry of Agriculture also announced that private traders and additional state-run operations would be allowed to participate.

Pakistan – With the objective of stabilizing domestic prices ahead of the Ramadan period, Pakistan is expected to shortly open tenders for the import of up to 375,000 tonnes of sugar, the bulk of which is expected to be raw sugar. Discussions also continue in general within the Ministry of Industry on proposals to review the duty structure on sugar to further facilitate imports.

AFRICA

Egypt – Following the removal in July of the EGP500 (US\$90) temporary import duty on refined sugar imposed earlier this year the government has also signed an agreement to waive the fixed import duties on raws (2%) and whites (10%) from mid-August to the end of December in order to calm domestic prices ahead of (and beyond) the Ramadan period.

EUROPE

EU – Decision was reached to extend the export limit for over-quota sugar for the current marketing year, from 650k tonnes to 950k tonnes. However, given the late notice, most of this new provision is expected to be shipped from October 2009 suggesting that 2009/10 exports for the EU could approach 1m tonnes.

WEATHER

El Niño – Sea surface temperatures ranged between 0.5°C and 1.5°C (exceeding El Niño thresholds) over the equatorial Pacific Ocean during July, which combined with other oceanic and atmospheric anomalies and westerly winds over Pacific reflect typical El Niño conditions. Leading dynamic models are anticipating that El Niño will continue to strengthen with the expectation currently for a moderate-to-strong El Niño event to be sustained across the Northern Hemisphere Winter 2009/10. ■

Outlook

Weather as always will play a leading role in developments in the months to come, with El Niño beginning to weigh in on proceedings. While its development may well be playing a role in the erratic Indian monsoon and could lead to a wetter harvest period in North America (and potentially a quieter Hurricane season in the tropical North Atlantic), its main implications are expected to be felt in the Southern Hemisphere in the new crop year. Perhaps as crucial for the market will be the demand response to the prevailing high prices (and cheaper starch sweeteners). The Chinese market has often demonstrated its flexibility in substituting between sweeteners and high

sugar prices could yet attract significant quantities of cane in India away from traditional pan sugar applications. Likewise, these prices are expected to truly test the sweet tooth of emerging economies. Political developments will continue to strongly influence market dynamics with the majority of domestic markets as sensitive to political market management decisions as they are to the S&D outlook. ■

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