

# Softs for 2004

After stuttering a little in early 2003, soft commodity prices, as measured by the Economist Intelligence Unit's (EIU) food, feedstuffs and beverages (FFB) index, continued to rise in the third quarter of the year. Soft commodity prices, although volatile, will tend to rise throughout the remainder of 2003, into 2004 and 2005, driven higher by a combination of stronger economic growth and the effects of 2003's drought related crop damage. By **MATT PARRY**, Economist Intelligence Unit.



**SOFT COMMODITY PRICES** in general will rise again in 2004, making for a third successive annual rise in the FFB index. Grains (notably maize) and oilseeds will push the index up, providing the lion's share of the upwards momentum, but also receiving marginal support from gently higher prices in the sugar sector. Beverages prices will be the only sector of our soft commodity index to fall in 2004, down 0.3%, as lower coffee and tea prices outweigh higher coffee prices.

The projected recovery in soft commodity prices will gather additional momentum in 2005 (forecast to rise by 11.1% in 2005 after rising 3.2% in 2004). Grains (with wheat providing strong support to maize) will again be the main contributor of the upward momentum in 2005, with some additional support from oilseeds and sugar. Prices for the beverages sector are forecast to move only very slightly up in 2005, as prices across the cocoa and coffee sector outweigh lower tea prices.

## Cocoa

Cocoa prices have retreated sharply from the 17-year high hit in late 2003, when - wrongly, as it has turned out - a hefty 2002/03 (October-September) deficit and serious disruption to Côte Ivorien shipments (by far the dominant producer) were being predicted, but remain well above the 27-year low touched in 2000. The EIU is forecasting relatively stable conditions ahead, as the market will be in near-balance in 2003/04 and 2004/05, based on the statically insignificant differences projected between supply and demand for both years. However, an underlying upward bias can be expected, as, after two seasons of drawdown running

(including a record 225,000 in 2000/01), stocks rose only modestly in 2002/03 and actually declined in relation to annual consumption - from 39.7% to 39.0%. This was only just above the 14-year low hit at the end of 2000/01, although safely above the 30% level that traditionally sets alarm bells ringing.

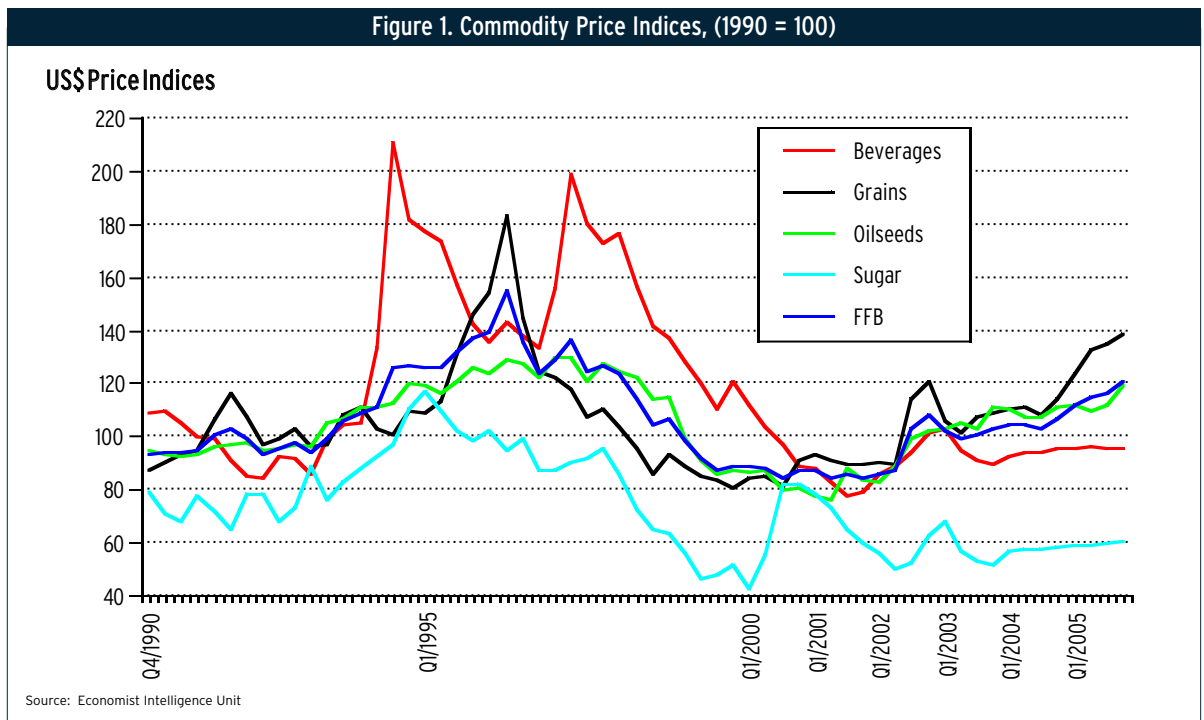
In making our predictions, we are assuming normal weather conditions and no serious deterioration in the Ivorien security situation, either of which would make the outlook much more bullish by prompting strong buying by industry - currently fairly well covered forward - and speculators.

> ... oversupply has become the rule rather than the exception in the coffee market <

## Coffee

Largely because of the expanded production capacity in Brazil and Vietnam (both low-cost producers) over the past ten years and sluggish demand growth, oversupply has become the rule rather than the exception in the coffee market. Coffee trees, which begin yielding commercially after three to five years and go on bearing fruit at a high level for 30 years or more, cannot be 'switched on and off'; they can be uprooted, or left unpicked, although farmers usually prefer to make something from them than do this. As a result, production is traditionally slow to react to depressed prices. The coffee market is also one where producing countries (especially Brazil) have shown a reluctance in recent years

Figure 1. Commodity Price Indices, (1990 = 100)



to co-operate to the degree needed to improve their collective lot, as the ignominious collapse of the Association of Coffee Producing Countries showed only too clearly. Competition for market share is therefore fierce, underlined by the limited impact of the International Coffee Organisation's voluntary programme designed to reduce supplies by outlawing the exports of sub-standard.

With no signs of significant cutbacks by producing countries, there is little scope for a further rise in prices from 2002's lows, especially given the high level of stocks in importing countries. At an estimated 25m 60-kg bags, they started 2003/04 at their highest level ever and 25% above that generally assumed to be the 'normal' working requirement. In view of the roughly balanced market seen ahead (both the projected 2003/04 deficit - the first for five years

to increase in the next two years as consumption and trade recover. Barley export prices will show an underlying firm trend because of strengthening feed markets, but will only come under strong pressure if there is a severe drought in the Middle East or North Africa. EU feed barley is forecast to rise by 8.4% in 2004 and 12.9% in 2005. Malting barley prices will generally be around US\$20-to-30/tonne higher.

World **maize** carry-overs in 2003 (end of respective crop years) are estimated at 94m tonnes, including 26m in the US and (at a guess) 38m in China. The total is projected to fall to barely 50m tonnes by 2006, including about 12m tonnes each for China and the US - the bare minimum in both cases.

In late 2003, the big US crop and China's large exports were keeping export prices down. Prices will probably stay low until the market starts to take proper account of the implications of China's much smaller exports and of the steep dive in US stocks. Prices will post double digit growth in both 2004 and 2005, as demand sharply exceeds supply. Indeed, once South Africa has disposed of its surplus, white maize prices should recover their premium of US\$5-to-10/tonne over yellow maize.

World **rice** stocks will again fall sharply in 2003/04, because of the major drawdown of stocks in China after its poor harvest. If the EIU is right in its judgement about China's carry-overs, there may be little scope for further decreases. As stocks in India have also been considerably reduced in the last two years, any upsurge in import demand from China (or anywhere else) would not readily be met. While the current forecasts do not assume that this will happen, at least before 2005/06, prices could become more volatile as markets factor in the various contingencies. Export prices of Thai white rice are forecast to firm gradually over the next two years, up around 5% per annum in both 2004 and 2005.

US **sorghum** stocks at end-August 2003 (the close of the marketing season) were only 1.0m tonnes, and following the

> The marker price ... will remain relatively stable in 2004 before rising more than 20% in 2005 <

- and the 2004/05 surplus are statistically insignificant), the EIU expects only routine buying by roasters and also fairly subdued speculative activity in the coming two years. Relatively stable prices are therefore indicated ahead. However, just as the market picked up in 2003 in anticipation of reduced 2003/04 supplies, because of Brazil's much smaller current crop, so the prospect of a big upturn there in 2004/05 (if confirmed) will start to exert downward pressure as 2004 unfolds. The higher price level in the first half of the year will therefore be cancelled out by losses in the second, provided there is no damage from frosts and/or drought to Brazil's 2005/06 crop prospects.

#### Grains

World **barley** stocks will fall to 20m tonnes at the end of 2003/04 after the small EU crop. They are not expected

small 2003 crop, are projected to fall further, to 0.9m, a year later. This is close to the minimum level needed to maintain supplies to export markets and domestic users. A bigger crop in 2004 should restore carry-overs closer to 2m tonnes, but they are liable to fall again the following season. The export prices are forecast to remain relatively unchanged in 2004, after rising more than 5% in 2003, but then, as US feed grain supplies start to tighten, it will rise up more than 15% in 2005.

**Wheat** stocks in the five major exporting countries are forecast to increase through the forecast period, although not to the extent that should put market prices under severe pressure. By the end of 2005/06 they are expected to amount to 49m tonnes, compared with an estimated 40m at the end of 2002/03. Markets will be demand-led, and particularly responsive to any suggestion that China may be about to start importing on a significant scale. The marker price (US hard winter wheat, fob Gulf ports) will remain relatively stable in 2004 before rising more than 20% in 2005.

### Oilseeds

Overall it is expected that **vegetable oils'** prices will show continued gains during 2003/04. The increases are likely to be seen in all the oils with the exception of **sunflowerseed oil** where the recovery in output is expected to cause reductions in absolute prices and in the sunflowerseed price relative to other oils.

**Tropical oils** seem set for greater increases than seed oils albeit from a lower base level. **Palm oil** prices look likely to rise relative to **soybean oil** prices. **Coconut** and **palm kernel oils** prices will also rise substantially but will continue to trade at levels that keep them competitive with the **edible oils**.

**Soybean meal** prices have changed little over the last three seasons. For the foreseeable future, soybean meal supplies appear to be inadequate to meet likely demand unless crushing activity increases significantly. Reserved selling of soybeans has kept crush margins at historically low levels but even small increases in soybean meal prices could encourage higher crushing activity. Current assessments suggest that soybean meal prices will post only a modest increase during the 2003/04 season to levels that will barely be maintained during the following two seasons.

### Sugar

World sugar stocks are expected to continue rising in 2003-2005 - though at a slower pace than seen in the past year. Most of the increases in the first year are expected in the EU, Brazil and China while Indian and Russian inventories could decline further. In tandem with gradual consumption growth this should prevent the current, burdensome stock/use ratio growing much to the forecast horizon.

World raw sugar prices improved well beyond market expectations in the third quarter of 2003, despite disappointing levels of Russian and Middle Eastern import demand. Partly this reflected 'outside' factors like the heavier investments made by managed funds and other large speculators in commodity markets. Strength also came from earlier fears that Brazilian exports might fall sharply with increased competition from ethanol and that EU output

would be worse hit by droughts and heatwaves. As the fourth quarter of 2003 unfolds, most of these fears have proved exaggerated and the prospect of larger supplies has caused an exodus of speculative money and a crash in prices to their lowest levels for a year.

The EIU continues to expect some price recovery over the next year or two, however, based on slower rises in world production and stocks and some improvement in demand.

### Tea

EIU estimates that the world tea market was in surplus for the 11th year running in 2003 shows just how firmly over-production has become entrenched. With no change foreseen in this situation to the end of our forecasting horizon, the outlook for prices - which in 2003, we estimate, were at their lowest level for nine years - remains decidedly bearish. Prospects, moreover, could be even worse than we predict, as our production forecasts for the four main exporting countries all err on the side of caution, as each has the potential to do much better than projected. Also bearish in the short-term is the unusually heavy volume of unsold tea India that will be carrying forward into 2004, because of its disappointing 2003 export performance, while two other factors will weaken the market structure generally in both the short and medium-term. They are the highly competitive nature of the tea market and the disproportionately heavy volume of poor quality tea that comes on the market every year, especially from Vietnam and China.

## > EIU continues to expect some [Sugar] price recovery over the next year or two <

In fact, we expect competition for sales to hot up, especially in the important Russian market, where Kenya and Bangladesh - following the lead of Sri Lanka, which has ousted India as the country's biggest supplier - are eager for an ever greater piece of the action. In the UAE, Saudi Arabia, Syria and its rival's other Middle Eastern strongholds, India is trying to win markets from Sri Lanka - and also hopes to increase its negligible slice of the Pakistani market (traditionally Kenya's fiefdom), following the recent trade deal between New Delhi and Islamabad. Kenya is touting for new customers in the US, Morocco and Libya and Sri Lanka is trying to win market share from Kenya in Egypt - and China and Vietnam everywhere. That the latter is making progress here was underlined by its selling its tea to 59 countries in 2002, 11 more than in 2001. China's quest for markets, meanwhile, will be helped by the progressive dismantling of import tariffs against its products now that it has joined the WTO ■

**MATT PARRY**, Senior Commodities Editor/Economist/Chief Energy Analyst. For a more complete analysis of the commodity markets, whether that be soft commodities or hard, simply contact the Economist Intelligence Unit E: London@eiu.com  
T: +44(0)20 7830 1007  
Or direct from our online store at [www.store.eiu.com](http://www.store.eiu.com)