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WORLD SUGAR OUTLOOK: ANOTHER VIEW

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In the brief time available this afternoon it will only be possible to pencil in the outlines and highlight some of the key features of the current situation for sugar. The tightening statistical position will occupy centre stage for much of the year ahead but there are also one or two longer term developments which may come into slightly sharper focus over the next twelve months. I will mention these later, not just to give myself the usual analyst's room for manoeuvre, but because, as the events in East Germany over the past month have graphically demonstrated, long run developments sometimes have a habit of taking a quantum leap forward.

All the ingredients are in place to make 1990 one of the more interesting and, perhaps, historic years that the sugar market has seen for some time. The long low price cycle which dominated much of the 1980s was the direct result of the large surge in production expansion that took place in the two seasons following the last bull market in 1980. Successive stock reductions over the past four seasons have gradually eliminated that excess stock so that by the end of August this year carry-over levels as a percentage of consumption had returned to those of 1980/81. Production in 1989/90 will improve over last season but only by a modest amount to some 107 million tonnes and, with consumption next year showing a potential to reach 109.5 million tonnes, there is every prospect of a further stock drawdown in 1990.

At these low levels there will be increasing resistance to drawing further sugar out of stock. Competing demand, together with the resulting market price, will determine where the balance will be struck between the limitations on consumption, where these take place, and the drawdown in stock. Whether or not this results in an old style bull market, the way in which world prices, producers and consumers interact over this tightening supply situation will also affect relationships and response patterns throughout the next decade.

Before we leave this chart there are some interesting comparisons with earlier bull markets. The low price cycle in the late 1970s was much shorter, only some five years, and not nearly as damaging for producers as other periods of low price. (The lowest monthly average in that period was 6.43c per lb in July 1978). This undoubtedly contributed to the readiness of producers to expand in the early 1980s after the last bull market. Despite the much higher peak of the 1974 bull market at 65.0c per lb, the subsequent production response was less immediate and more gradual. Producers retained harsh memories of the much lower prices of the late 1960s and early 1970s which had prevailed over a much longer span. The parallel with the latest low price cycle is very marked and the trauma of rationalisation suffered by many industries after the very low prices in 1985 may still inhibit unrestrained expansion now that prices are improving.

Before we get carried away with all these pointers to a possible new bull market for sugar, it must not be forgotten that the world market is essentially residual in nature and that many of the major participants can show wide reversals in their respective balances, often within the course of one crop. I will touch on a few of these by way of illustration.

From the start Brazil's fuel ethanol policy has been one of the major concerns for the market. The allocation of significant quantities of cane, currently some 70 per cent of the entire crop, to distilleries depends on the government's Proalcool programme being maintained. How firmly would this hold if sugar prices were firm and oil prices low? In the event the threat of cane supplies being switched from alcohol distilleries to the sugar sector has not materialised and, if anything, the reverse has happened as strategic stocks of fuel alcohol have been run down over the past two seasons to maintain performance in sugar. This season exports of sugar will decline to less than one million tonnes while there is also a deficit of fuel ethanol.

There are more than four million vehicles running on pure ethanol and the scope for switching fuels is limited to older cars burning gasohol blends. However, you will have seen recent reports that subject to Government approval, Brazil has purchased 1.5 billion litres of methanol, valued at some $100 million, to make up the deficit in domestic ethanol production this season. To produce this quantity as ethanol would have required some 20 million tonnes of cane, or, say, two million tonnes of sugar, which in today's white sugar market would be worth $800 million. This illustrates some of the pressures on the Proalcool programme and, if current low methanol prices continue, it would be tempting for Brazil to extend this approach, possibly into the 1990/91 season. The size of Brazil's cane crop has shown very limited growth for several seasons and, with growers finding other crops more attractive, it may require new government initiatives to encourage expansion. On the other hand the methanol option may be a short term method of bringing more cane to sugar mills for both the export market and the growing domestic sugar market. The pie chart shows how small shifts in cane for ethanol could have significant impact on export volumes for sugar.

India is another producer where important quantities of cane have an alternative outlet to sugar mills and last season there was a major reversal in the prospects for sugar production following a relatively minor shift in the percentage of cane deliveries. In 1987/88 sugar mills utilised a historically high proportion of total cane - some 48 per cent. Expectations of a similar share formed the basis of initial estimates for 1988/89 with hopes that sugar production might reach 10.9 million tonnes, raw value. Producers of gur and khandsari competed more strongly for cane, however, and the sugar mills' share slipped to 44 per cent of a cane total that had slipped back slightly so that final production only reached 9.455 million tonnes. Such a large swing turned hopes for exports into a need for imports.

This season the cane crop is expected to rise by some six to seven per cent to 210 million tonnes but once more sugar performance will depend on the amount of cane diverted to gur and khandsari manufacturers who again are competing strongly for supplies. Our estimate of 10.3 million tonnes is higher than some industry forecasts at 9.57 million tonnes but further imports would seem to be needed later this season as consumption continues to forge ahead. Cane prices were raised as part of a pre-election agricultural package but further policy changes may well be needed if India is not to continue as a regular importer of sugar.

The Soviet crop is providing the basis for a wide range of estimates and the issue centres on whether the acknowledged good state of the crop in the ground has been put at risk by delays in transporting beet to the factories. Latest reports indicate that our most recent forecast of 9.25 million tonnes may have to be increased to between 9.5 and 10.0 million tonnes. Possible buying on the world market will relate not only to domestic production but also to deliveries from Cuba where earlier expectations of another high crop may have to be scaled back as rains have been below optimum. In the longer term the increasing application of Intensive Cropping Technology (ICT) in the USSR and the general drive towards improving agricultural efficiency through joint ventures can be expected to show results as we move through the 1990s. Whether such gains will be achieved sooner rather than later is still too early to tell.

Per capita consumption is already quite high at 46 kilos per annum but the authorities may decide to build up pipeline distribution in order to restore consumer confidence in the availability at retail level. Depending on the progress of reforms and economic activity, and as a result supplies of goods to consumers, there is likely to be a speed up in the switch to industrial usage as opposed to direct consumption of sugar.

China has played a key role in market behaviour over the past two years. Imports in 1988 approached nearly 4.0 million tonnes and drove up premiums in the Far East for raws over futures prices, even to the point of attracting western hemisphere sugars into the area. With some of that sugar surplus to immediate requirements, China has been able to keep a low profile for much of this year by destocking and restricting internal demand leading to the collapse of the Far East raws premium. I believe that China will have to return to the world market next year but the authorities will need to resolve the problems raised by their low internal price structure, especially as world prices move higher.

Low consumer prices for 25 years and more have spurred internal demand which until last year was also fuelled by general economic development. During the first seven years of this decade the annual growth in sugar consumption averaged ten per cent. With more industrialised projects being set up in rural areas, resources and manpower were being diverted from traditional crops and farmers were finding new and growing demand for alternative cash crops as a result of increased spending power in large urban population centres. Improving yields masked this decline in area for a time but production slumped in 1987/88 leaving a substantial deficit last year.

Last year the government attempted to free up internal prices in various sectors but the rapid inflationary effects which followed brought the programme to a halt. For a time the authorities found they were subsidising both sides of the sugar equation with producer subsidies to encourage farmers to increase production and consumer subsidies to alleviate the impact of price rises. Both actions masked each sector from the price signals which would lead to a correction of the situation. There have been numerous predictions from Chinese sources that a deficit situation is expected to continue for some years to come and with per capita usage at only six kilos per year, the potential for demand growth is enormous and will be significant for the world market throughout the 1990s. At that level any improvement in offtake will be strongly linked to economic development. The nettle to be grasped by the authorities is how and when to resume the moves towards market economics in the sugar sector.

The EEC this season has shown the extent to which beet seed technology and farming practices are now able to overcome quite adverse conditions. After poor emergence for some later sown beet, a very dry summer and potential problems from virus yellows, it now seems that as campaigns move into their closing stages production will actually show an improvement over last season at 14.83 million tonnes from beet.

There are also indications that current world prices will encourage producers to reduce the amount of 'C' sugar carried forward from season to season. Declarations do not have to be made until the New Year when the final amounts will reflect the world price outlook at that time. Already estimates of 500,000 tonnes have circulated in white sugar terms with some even suggesting that as little as 300,000 tonnes may be declared. Since 1.1 million tonnes were carried in from last season to this, the difference will represent an additional availability to be marketed next year over and above any current crop surplus.

Some producers have already negotiated forward sales of 'C' sugar for several years and as they will be anxious to avoid weather related problems placing these in jeopardy, it is likely that areas sown to beet next spring will increase after the static or falling trend of recent years.

I should also make a quick reference to Mexico where privatised mills facing weather problems seem set to produce another poor crop, requiring imports of possibly 3/400,000 tonnes to fulfil consumption next year. After destocking too much in 1988, Mexico will import whites (750,000 tonnes) and exported raws (450,000 tonnes) this year and has been a major influence in the high premiums and tight supplies of white sugar.

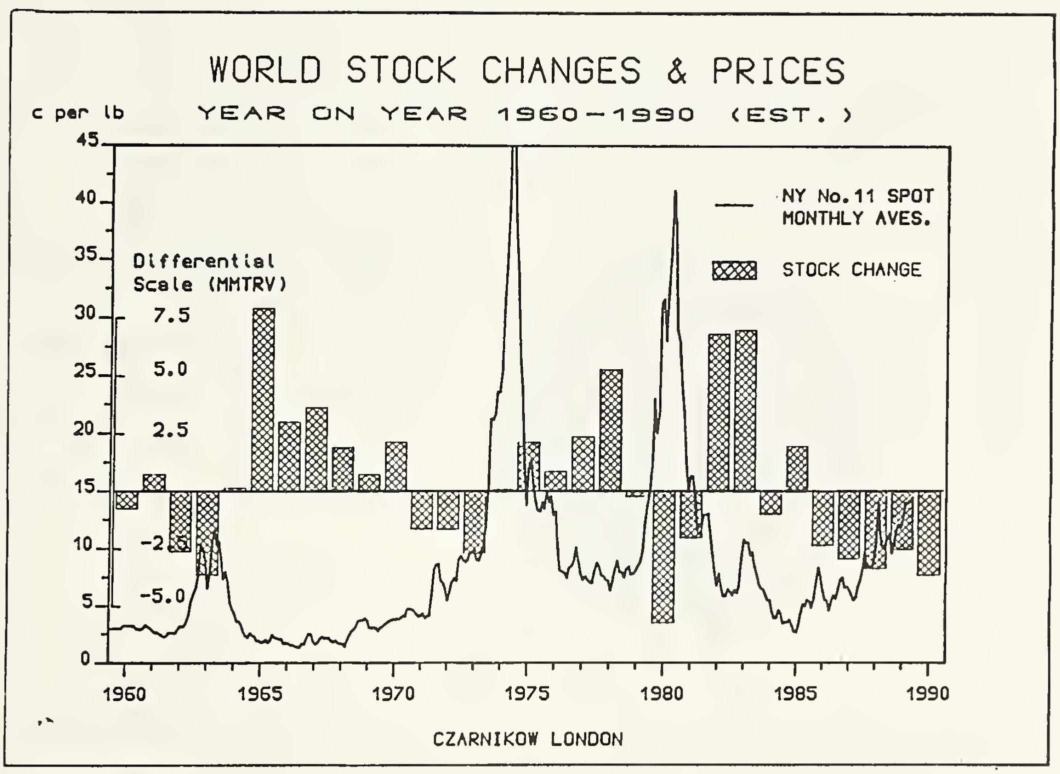
And so to the likely responses this season. For supplies, the EEC can destock for one season while Brazil and India might even at this late stage revise policy to boost sugar. The Soviet crop is not so much a response to prices as a measure of the progress of reforms. However, it would seem that we must look forward to 1990/91 crops before a major recovery in production is possible. But by 1991 demand is likely to approach 111 million tonnes and production will need to advance by some four to five million tonnes just to achieve balance without rebuilding stock. A crude aggregate of the best crops over the past decade indicates that installed capacity world wide probably exceeds 120 million tonnes. There are several instances, however, (Brazil and Philippines) where the lack of available cane may frustrate a repeat of the previous best performance.

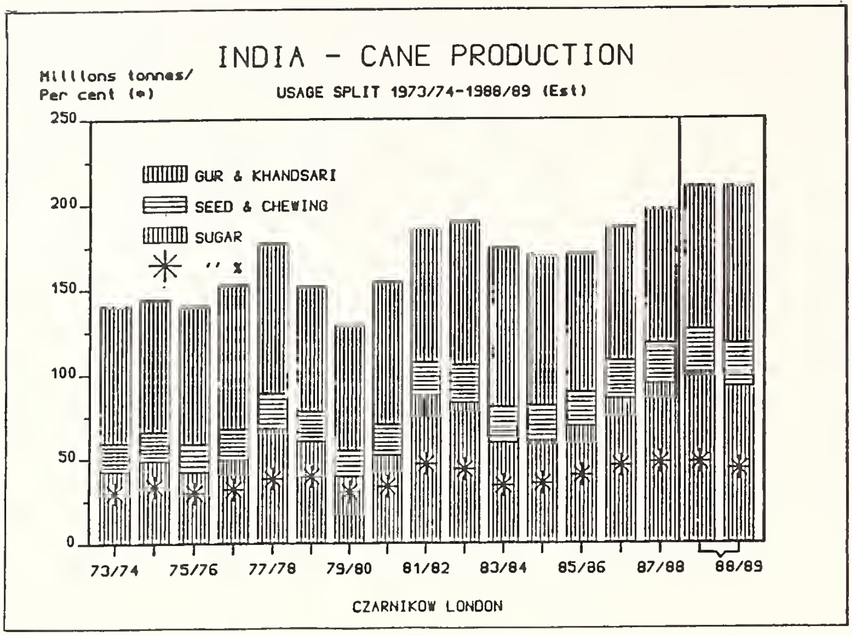
For demand the most vigorous growth rates throughout the 1980s have been recorded in Asia and higher world prices are likely to moderate these. Many of the economies in the region have also shown good growth and it should not be assumed that all will necessarily show high price elasticity. Next year will prove to be an interesting test bed for new demand/price relationships.

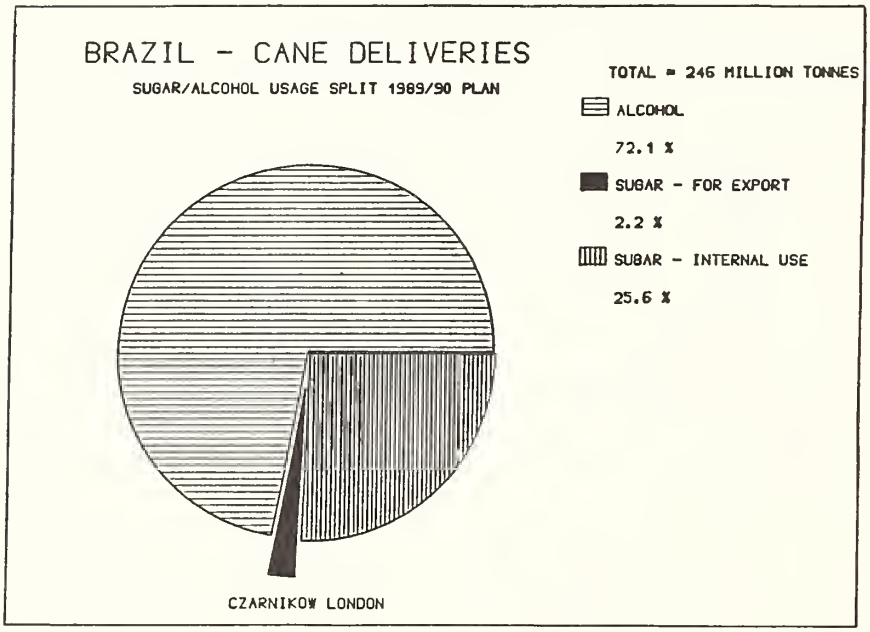
The cyclical and structural change approaches for assessing sugar price behaviour have often been presented as mutually exclusive and in conflict. In fact I believe the two can co-exist. The residual nature of world trade continues to mask price signals to major portions of the world's production and consumption and as a result delays are inevitable in responding to world surplus or shortage. A cyclical pattern is likely to remain, although the intervals and extent of price extremes may well be modified. The availability of more alternative sweeteners will not fill a sudden deficit but, like sugar, those producers will gear up new production after a high price stimulus. The greater portion of third world countries importing sugar may affect the extent of any new peaks although many of those economies have grown rapidly while buying decisions at times of shortage can still be driven strongly by political considerations. All in all 1990 promises to be a fascinating year for sugar with the focus for tight supplies likely to emerge for the third quarter of the year.

In closing I would like to come back to the economic and political reforms that are sweeping across many socialist countries in East Europe and throughout the world. These will bring important changes throughout the 1990s as more and more adopt market economics. It is too early to predict where these changes will lead, so fast have recent developments taken place, but as producers adapt to incentives and consumers leave their false security of fixed prices, both sides of the supply/ demand equation will evolve new relationships over the next few years.

Another major initiative is the current Uruguay Round of Multinational Trade Negotiations (MTN) which has targetted agricultural support and access to markets as areas for reform. There has been less north/south dialogue and more of conflict between the main industrialised countries of the USA, EEC and Japan defending their exisiting support policies for domestic producers. Despite this apparent lack of progress, the topic remains firmly on the agenda and, should a system for reforms ever be agreed, progress could be surprisingly rapid. This, together with the reforms demanded in centrally planned economies, could well represent a major potential for structural change in the sugar economy over the coming decade. Internal markets would add a significantly broader base to the areas which are responsive to world price signals and we would have to rewrite our models. Before last month such notions could be comfortably pigeonholed into a 'long term' only category but after recent events such possibilities must be brought forward and the 1990s promise to be a stimulating time for sugar.




INDIA - CANE PRODUCTION
Millions tonnes/
Per cent (*)
USAGE SPLIT 1973/74-1988/89 (Est)
GUR & KHANDSARI
SEED & CHEWING
SUGAR
'' %
250
200
150
100
50
0
73/74
75/76
77/78
79/80
81/82
83/84
85/86
87/88
88/89
CZARNIKOW LONDON


BRAZIL - CANE DELIVERIES
SUGAR/ALCOHOL USAGE SPLIT 1989/90 PLAN
TOTAL = 246 MILLION TONNES
ALCOHOL
72.1 %
SUGAR - FOR EXPORT
2.2 %
SUGAR - INTERNAL USE
25.6 %
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