Agri Commodity Markets Research

February 2019: Spring Summits, Wheat Plummets

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February yielded important progress in US-Chinese trade talks that, at a minimum, delayed March 1 tariff hikes and increased soy purchases from China. China reportedly offered to buy an additional USD 30bn/year of US farm products, more than double its typical imports and equivalent to one-quarter of the US's entire farm exports in 2017, underlying the price risks ahead. In Brazil, weather conditions have improved in February, benefiting corn and coffee production. CBOT Wheat plummeted 10% last month, as a potential bumper crop in summer spurs an aggressive global stock sell-down.

WHEAT

CBOT Wheat bears emerge from dormancy after tranquil winter as competition tempers US demand.

- CBOT Wheat was the worst G&O performer last month, as international competition stifled US sales.
- 2019/20 US winter acres fell due to poor planting conditions, but global increases offset the decline.
- Global stocks are concentrated in the US, raising price upside if dryness risks emerge in the EU/FSU.

CORN

The calm before the storm: CBOT is at risk of breaking out of its narrow trading range.

- US 2019 plantings: soy/corn calls for higher US corn acreage, but wet fields/weather and US-Chinese trade negotiations might bring surprises to final plantings.
- US 2018/19 corn use in feed/ethanol cut. US exports continue to face heavy competition and a lower wheat/corn price ratio.

SOY

Looking ahead, Chinese demand and US planting decisions risk capping CBOT Soybean recovery.

- Chinese commitment to purchase 10m mt more US soy, a trade truce extension, and US farmer subsidies keep CBOT Soy shorts sidelined.
- US stocks, soy/corn ratio increase risks from no-deal.

PALM OIL

Our 2019 palm oil price forecast is revised higher due to a larger-than-expected palm oil inventory drawdown in Indonesia.

- The B20 mandate will limit palm oil inventories built up in Indonesia in 2019.
- Spread between soy oil and palm oil could narrow if US-Chinese trade negotiations result in a 'no-deal.'

SUGAR

ICE #11 Sugar price forecast maintained.

- Current market prices do not incentivize sugar production in Brazil – but they will have to do so next season, starting from April.
- Weather has significantly improved in Brazil, improving the prospects for cane growth
- Australia is still being affected by drought

COFFEE

We lower our price forecast as Brazil crop outlook improves

- ICE Arabica has dropped ~USc 8/lb during the first half of February, coinciding with a return of rainfall over Brazilian key areas.
- Honduran sales have improved, but are still lagging.
- Demand seems to be doing well, as stocks have increased less than expected.

COTTON

ICE #2 prices face pressure, on both the short-term demand outlook and supply expectations for 2019.

- The USDA brings bearish news: 1. large early 2019 US area forecasts, 2. poor Chinese import demand (from the US), and 3. cuts to 2018/19 global demand growth.

Wheat

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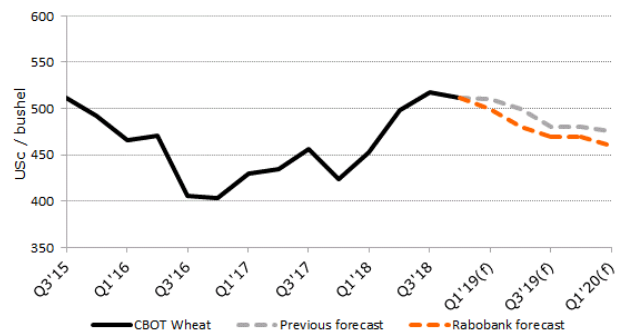
- 2019/20 US winter acres fell due to poor planting conditions, but global increases offset the decline.
- Global stocks are concentrated in the US, raising price upside if dryness risks emerge in the EU/FSU.

CBOT Wheat likely performed its swan song last month, diving below USD 5/bu as fierce global discounts dashed hopes for US demand pick-up. So far, last summer's drought-induced global supply cuts have failed to deliver marked export growth in the US. Instead, we've seen wheat farmers in France, eastern Europe, and Russia opting to sell down accumulated stores to take advantage of three-year-high prices. Large acreage increases in major exporters (+4% YOY) and a mild winter are accelerating the sell-off, as farmers see increasing likelihood of a return to global surplus, which Rabobank pegs at +8m mt YOY. CBOT is tracking global wheat declines to remain competitive on an FOB basis, but freight advantages for the EU/FSU to the large wheat buyers in the Middle East and Africa will require the US to open up a significant origination discount to its competitors.

Bearish supply signals for CBOT Wheat have been compounded further by hand-to-mouth buying and large-scale switching to cheaper animal feed grains – especially corn and, more recently, feed barley. Major importers across North Africa, the Middle East, and South Asia enjoyed production growth last year, and the lack of supply shocks allowed them to minimize purchases and wait for better prices this summer. As a result, overall demand for wheat in 2018/19 will decline for the first time in six years, by 2.5% YOY.

CBOT Wheat outlook weak as large 2019 global crop looms

	unit	Q2'18	Q3'18	Q4'18	Q1'19(f)	Q2'19(f)	Q3'19(f)	Q4'19(f)	Q1'20(f)
CBOT	USc/bu	499	517	512	500	480	470	470	460
Matif	EUR/t	173	199	202	195	185	180	178	175

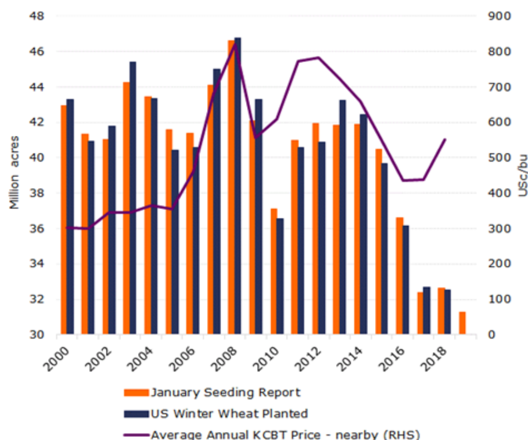


Source: Bloomberg, Rabobank 2019

There is a long spring period ahead, before the large global harvest is gathered. Temperature forecasts in Europe and North Africa are warmer-than-normal – and with wheat emerging, we could see current soil moisture buffers erode and weather risk take hold. Wheat demand will also pick up in coming months, as buyers capitalize on year-to-date declines of ~10% in CBOT Wheat and ~25% in the wheat/corn ratio to restock and switch feed rations to higher wheat inclusion rates.

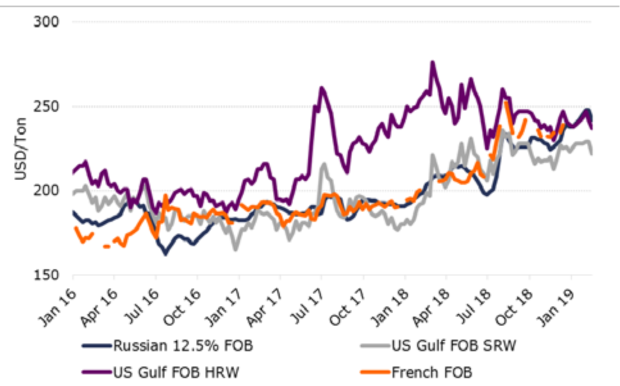
In the US, 100-year-low wheat acreage in 2019/20 (the result of wet planting conditions), combined with minor freeze damage this winter, could wind up trimming stocks where demand could not. Furthermore, the stocks drawdown in exporter countries – six-year lows, with stocks-to-use at 11-year lows – raises strong upside risks for CBOT. The US holds the world's exportable reserves and any supply shock will drive roughly equivalent export demand there and lift CBOT. Given the small margin for production failures, further CBOT declines could present buying opportunities. Still, absent a weather issue and with the new harvest arriving next quarter, we expect export competition from eastern Europe & France will erode US export market share and CBOT support.

The lowest US Winter Wheat plantings in a century will cut stocks



Source: USDA, Rabobank 2019

US has had to price itself aggressively against falling Russian, EU values with freight an inherent disadvantage.



Source: Bloomberg, Rabobank 2019

Corn

The calm before the storm: CBOT is at risk of breaking out of its narrow trading range.

- US 2019 plantings: soy/corn calls for higher US corn acreage, but wet fields/weather and US-Chinese trade negotiations might bring surprises to final plantings.
- US 2018/19 corn use in feed/ethanol cut. US exports continue to face heavy competition and a lower wheat/corn price ratio.
- US-Chinese trade negotiations might bring additional demand for US products (for next season), as China proposed to more than double imports of US agri products compared to 2017 levels.

US-Chinese trade negotiations could bring a bullish surprise to corn. A failure to strike a deal will mean the end of US soybean exports to China – and the resulting substantial bearish impact on CBOT Soy prices will have a knock-on effect on corn and other products. However, the latest Chinese proposals to purchase an additional USD 30bn of US agri products per year – on top of the USD 24bn purchased in 2017 – has the potential to inject bullishness into CBOT prices. Such a deal would not only require US soybean exports to almost exclusively move to China, but would also entail significant corn, DDGS, sorghum, ethanol, and meat exports to China. We expect trade negotiations to last for several months, and such volumes (if at all) might only be required to be shipped to China from 2019/20 onward.

US 2019 acreage raises many question marks. The current soy/corn price ratio favors the planting of corn over soybeans in the US. In its Agricultural Outlook Forum, the USDA estimated corn acreage at 92.0m ac, up 3.2% YOY. Overall, this seems realistic, but the market needs to prepare for larger swings in acreage: field work to prepare for corn might become an issue – with parts of the Midwest relatively wet – and farmers might not get all the corn planted they intend.

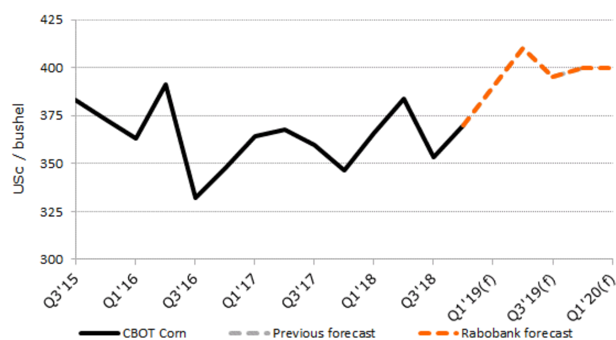
US 2019/20: 2m acres more at unchanged yield still drive slight deficit. 180bpa keeps balance stable

US Corn S&D	USDA Feb		2019/20 scenarios		
(Mn Acres/Mn bu.)	17/18(f)	18/19(f)	low	base	high
Beginning Stocks	2,293	2,140	1,735	1,735	1,735
Area Planted	90.2	89.1	89.0	91.0	91.0
Area Harvested	82.7	81.7	81.6	83.5	83.5
Yield	176.6	176.4	174.0	176.5	180.0
Production	14,609	14,420	14,207	14,735	15,027
MY Imports	36.3	40.0	40.0	40	40
Total Supply	**16,939**	**16,600**	**15,982**	**16,510**	**16,802**
MY Exports	2,438	2,450		2,500	
Feed Consumption	5,304	5,375		5,450	
FSI Consumption	7,056	7,040		7,075	
Ethanol Usage	5,600	5,625		5,650	
Domestic Consumpti	12,360	12,415		12,525	
Total Usage	**14,799**	**14,865**	**15,025**	**15,025**	**15,025**
Ending Stocks	2,140	1,735	957	1,485	1,777
YOY stock change	-153	-405	-778	-250	42
Stocks/Usage	14%	12%	6%	10%	12%

Source: USDA, Rabobank 2019

CBOT Corn price forecast maintained, but risks increasing

	unit	Q2'18	Q3'18	Q4'18	Q1'19(f)	Q2'19(f)	Q3'19(f)	Q4'19(f)	Q1'20(f)
Corn	USc/bu	384	353	370	390	410	395	400	400



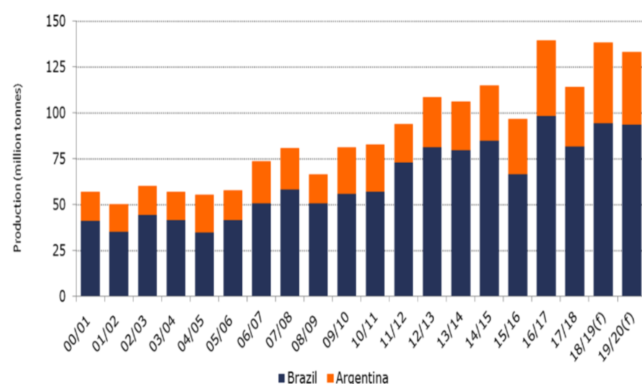
Source: Bloomberg, Rabobank 2019

However, there is still time for conditions to improve. And the described trade war uncertainty can heavily play into farmers' planting decisions: a quick deal might drive more acres into soy, while negative signs out of the talks would favor higher corn plantings.

Positive South American corn production outlook. Brazil's full-season corn crop, at 23m-24m mt, combined with safrinha corn is likely to drive total corn production to the second-highest on record, at close to 95m mt, vs. 81m mt last season. Safrinha plantings progressing at a record pace are providing a good base for strong yields, but weather risks can still hurt the crop. Overall, Argentine corn is in good shape and is forecast to hit a record, at above 42m mt, compared to 32m mt last season and to the previous high of 41m mt in 2016/17.

Corn exports from Ukraine rose by 75% YOY for the September-to-January period, and the country has more volumes left for export. US corn exports – at 981m bu until February 21 2019 – an increase of 38% compared to last season - is benefiting from the facts that global corn demand for feeding stayed strong and because Brazil's Q4 exports fell year-on-year as soybeans used elevation capacity.

South American 2018/19 production will recover, with improvements in both Argentine and Brazilian forecasts



Source: USDA, Rabobank 2019

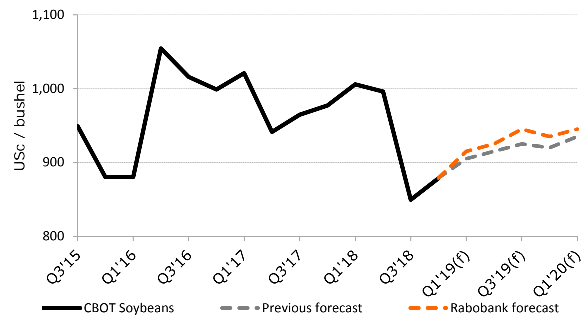
Soybeans

Looking ahead, Chinese demand and US planting decisions risk capping CBOT Soybean recovery.

- Chinese commitment to purchase 10m mt more US soy, a trade truce extension, and US farmer subsidies keep CBOT Soy shorts sidelined.
- China's soy purchases to date are below expectations, raising questions on the reliability of trade commitments.
- Moderate South American production cuts are largely offset by farmer-selling and Chinese ASF-hit demand.
- US stocks and soy/corn ratio increase risks from no-deal.

CBOT Soybean forecast higher, with upside checked by large stocks, low Chinese demand & rising soy/corn ratio

	unit	Q2'18	Q3'18	Q4'18	Q1'19(f)	Q2'19(f)	Q3'19(f)	Q4'19(f)	Q1'20(f)
Soybeans	USc/bu	996	849	879	915	925	945	935	945



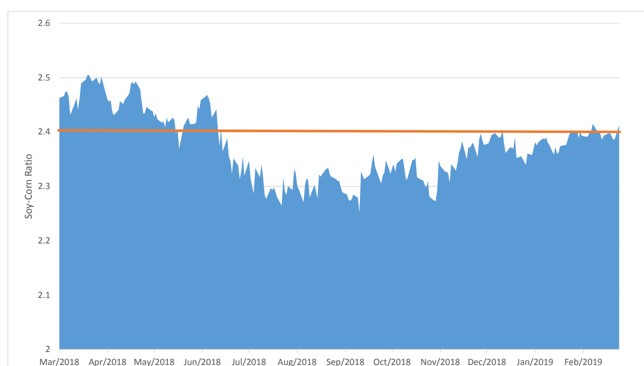
Source: Bloomberg, Rabobank 2019

CBOT Soy remained in its delicate limbo last month, above USD 9/bu, awaiting direction from the trade war decisions that will determine long-term bull-bear market prospects. The positive overtures from both sides – including a US freeze on higher tariffs and a Chinese commitment to buy an additional10m mt– mask two important risks for CBOT. The first is that China's promises have so far gone unfulfilled: through February, purchases were ~8m mt, vs. an expected 10m mt – raising important questions as to the reliability and enforcement of eventual F&A trade commitments under a trade deal, rumored to be ~USD 55bn/year (2017: USD 24bn).

The second emerging concern for CBOT is that cautious trade optimism is seeping into the planting season, and US farmers are expected to limit soybean cuts on the expectation of a trade deal. Currently, the CBOT Soy/Corn ratio is at 2.4 – which typically favors soy plantings. The factors underpinning CBOT current support are largely theoretical and contradict the US's grim demand reality. US soy export commitments are running 16% slower than their five-year average and will struggle to reach the USDA's (recently lowered) target; meanwhile, quarterly stocks are at a record 3.7bn bu, 19% higher YOY. Still, Rabobank expects the CBOT Soy/Corn ratio to retreat during March, absent a resolution with China. US farmers will elect to cut to 4m soy ac, in favor of the safer planting choice: corn. In case China and the US agree to a deal, the result will likely boost CBOT Corn as well as Soy; however, in case of a no-deal, US soy is far more exposed than corn.

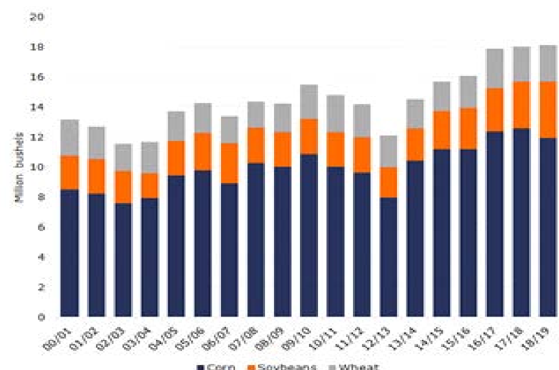
The November trade truce that sparked CBOT's 10% rally coincided with South American harvest price pressure. Together, these events eroded a record FOB soy spread between the US and Brazil, along with US export dominance to the world (ex. China) market. With China (typically 55%-60% of world soy demand) still largely eschewing US soybeans – the latest agreement brings its US soy purchase to ~20m mt, 70% of normal – the US is relying on the rest of the world, particularly the EU, to limit its demand losses. Last month, emerging production cuts in Brazil (7% YOY) and FX weakness in Argentina (where farmers use soy as an inflation hedge) helped US soy to maintain its small FOB discount. But if traditional South American harvest pressure arrives, it will leave record US stocks reliant on Chinese goodwill purchases, a dangerous prospect absent a signed trade deal and given China's ASF-hit import demand (88m mt, -2m mt YOY). If a trade deal happens, it will require China to buy >70m mt US soybeans in 2019/20, shifting global stocks and price pressure to South America and reversing the FOB spread. Either way, with the trade war end-game approaching, there is strong potential for geopolitical price volatility in the months ahead.

Soy/corn ratio has rebounded since late 2018 stands at 2.4 implying limited soy acre cuts during this spring



Source: Bloomberg, Rabobank 2019

US G&O stocks expanded last quarter, driven by record soy



Source: USDA, Rabobank 2019

Soymeal and Soy Oil

CBOT Soy Oil and Soymeal demand fortunes and spread complete their reversal from 2018.

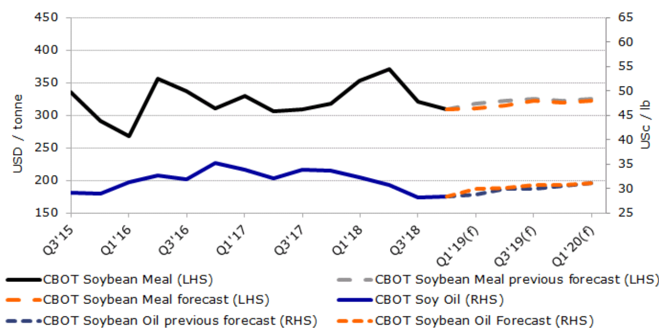
- Historically low soy oil prices and record biodiesel demand are mopping up accumulated 2018 stocks.
- Brazil's domestic demand limits soy oil exports. Meanwhile, import demand is strong, particularly in Asia.
- High pork inventories in China (ASF) limit short-term demand upside for CBOT Soymeal, but herd rebuilding or a trade deal could provide a delayed price boost.

CBOT Soy Oil continues to shine among its G&O peers in 2019, up 10.5% YTD courtesy of record biodiesel demand that is driving a global stock drawdown. Rabobank maintains its 2019 call that CBOT Soy Oil's move higher is justified by strengthening fundamentals. The supportive catalysts include, biodiesel's discount to rising Brent Crude, Brazil's export limitations, and China's domestic supply shortfall. Rabobank expects the recovery to endure in 2019 as the global vegetable oil glut recedes. Evidence of soy oil's demand-led recovery can be seen in NOPA reports: last month, it reported a 10% YOY decline in soy oil stocks despite record soymeal production, while in seven of the last nine reports, disappearance has been greater than expected.

Soy oil's recovery will be further bolstered in 2019 by a sharply curtailed South American export program and China's lower soybean imports. Dryness is expected to cut Brazil's soy production by 5% YOY – and amid growing domestic biodiesel requirements (11% mixture, up from 10% currently, rising to 15% by 2023), its exports will fall to 700,000 mt in 2019 (-50% YOY), driving global demand to the US and Argentina. Meanwhile, ASF in China will result in the first soy import cut in nearly two decades, with a knock-on effect that it will need to increase soy oil imports by 500,000 mt (+60% YOY) to replace lost production. Amid annual global vegetable demand growth of 3.5% and falling

CBOT Soy Oil buoyed by biodiesel, while low Soymeal demand expected to recover from ASF

	unit	Q2'18	Q3'18	Q4'18	Q1'19(f)	Q2'19(f)	Q3'19(f)	Q4'19(f)	Q1'20(f)
Soymeal	USD/tonne	371	321	309	310	315	322	320	322
Soy oil	USc/lb	30.7	28.2	28.3	30.0	30.2	30.6	30.6	31.0

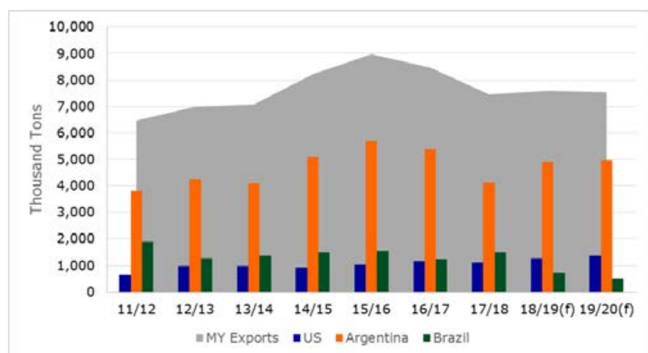


Source: Bloomberg, Rabobank 2019

exportable supplies, we remain supportive of CBOT Soy Oil below USc 30/lb, particularly ahead of a potential trade deal with China.

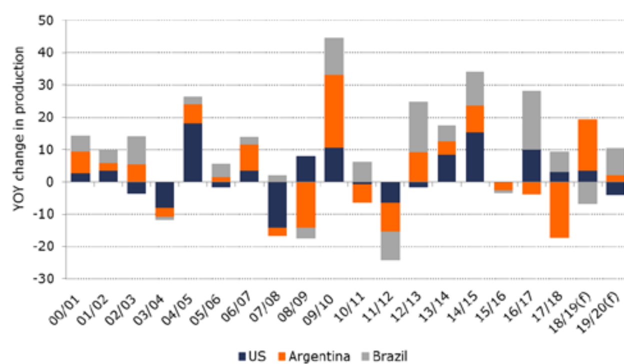
China's ASF and South America's soy replenishment are near-term depressants for CBOT Soymeal. Still, Rabobank expects the demand hangover to be short-lived, lifting historically low prices by Q2/Q3 2019. US crush margins have shown signs of stabilizing from their 60% decline and remain 40% above their five-year average. This is incentivizing record US soymeal production, with January NOPA reporting the fourth-largest crush on record. US crushers are expected to be close or at capacity in 2018/19, which will be supportive for CBOT Soymeal. Meanwhile, poor South American margins are blunting the impact of renewed production and export competition with the US. In China, the widespread culling of ASF-affected hogs has left a massive pork surplus that is pressuring domestic soymeal prices to three-year lows and the world's largest import market. Conversely, Rabobank expects the current Chinese herd deficit to support rebuilding by Q3 2019, which should preclude a sharp reversal in soymeal and pork prices. Meanwhile, any major spread of ASF in the EU (the largest exporter to China) will US hog prices and CBOT Soymeal. The biggest downside risks to CBOT Soymeal in 2019 are large US soybean plantings or the spread of ASF to the US, and not the US-China trade war. The US is not dependent on Chinese soymeal trade, while its crush margins have proven to benefit from China's strong bidding for South America's soybeans.

Brazilian soy oil exports will fall over the coming years amid higher biodiesel requirements, boosting US demand



Source: USDA, Rabobank 2019

Replenished Argentine soybean production will weigh on CBOT soymeal, however its crush margins remain depressed



Source: USDA, Rabobank 2019

Palm Oil

Our 2019 palm oil price forecast is revised higher due to a larger-than-expected palm oil inventory drawdown in Indonesia.

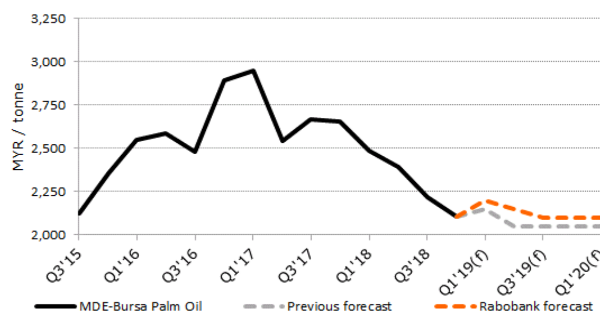
- The B20 mandate will limit palm oil inventories built up in Indonesia in 2019.
- Malaysian and Indonesian February 2019 palm oil production and inventories will be lower MOM.
- The spread between soy oil and palm oil could narrow if US-Chinese trade negotiations result in a 'no-deal.'

The B20 mandate will limit palm oil inventories built up in Indonesia in 2019. According to APROBI, Indonesian domestic biodiesel consumption increased by 67% YOY, to 4.3m kl. The increase was driven by the implementation of the B20 mandate in September 2018, which increased Indonesian total biodiesel domestic usage for transportation by 1.2m kl YOY, to 3.5m kl in 2018. Although the Indonesian government only managed to reach 86% of its B20 implementation target in 2018, the combination of this mandate and strong palm oil exports in Q4 2018 resulted in a year-on-year reduction of Indonesian palm oil inventories. According to GAPKI, Indonesian palm oil inventories decreased by 19% YOY, to 3.2m mt in December 2018. While we think that the increase in Indonesian palm oil production in 2019 is more than compensating for the implementation of the B20 mandate in the country, the reduction of Indonesian palm oil inventories in 2018 was still higher than expected. Hence, we have revised up our 2019 price forecast to an average of MYR 2,138/mt.

Malaysian and Indonesian February 2019 palm oil production and inventories will be lower month-on-month. According to MPOB, Malaysian January 2019 palm oil production decreased by 4% MOM, to 1.7m mt; however, it increased by 9.5% YOY. Meanwhile, Malaysian palm oil exports for the same month increased by 21% MOM, to 1.7m mt. As a result, Malaysian January 2019 palm oil inventories decreased by 7% MOM, to 3m mt. We expect palm oil inventories in

Palm oil price revised higher, but remains subdued in 2019

	Unit	Q2'18	Q3'18	Q4'18	Q1'19	Q2'19(f)	Q3'19(f)	Q4'19(f)	Q1'20(f)
Palm Oil	MYR/mt	2,391	2,219	2,220	**2,200**	**2,150**	**2,100**	**2,100**	**2,100**



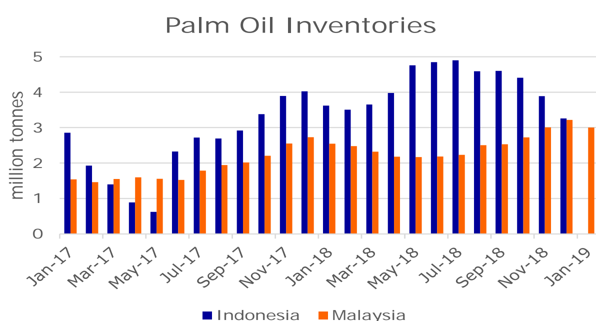
Source: Bloomberg, Rabobank 2019

Malaysia and Indonesia to further decrease in February 2019, due to a seasonal production downtrend and relatively stable inventory drawdown. Despite this situation, the palm production cycle is expected to shift to a seasonal uptrend from March 2019 onward.

The spread between soy oil and palm oil could narrow if US-Chinese trade negotiations result in a 'no-deal.' The spread between CBOT Soy Oil and MDE-Bursa Palm Oil active contract prices was around USD 107/mt in mid-February 2019, which ensures palm oil remains price-competitive compared to soy oil. However, CBOT Soybean prices could move back to their September 2018 low, dragging down CBOT Soy Oil prices if the US decides to and exert further tariff pressure on China.

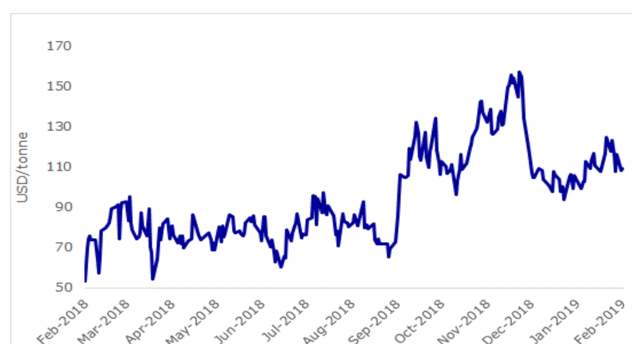
The Indonesian government will decide on the 2020 B30 mandate implementation in Q4 2019. From March to October 2019, the Indonesian government will conduct its road test to evaluate the feasibility of a B30 mandate. If the results are positive, the B30 mandate will be implemented in January 2020, translating to a total annual domestic biodiesel demand of ~9m kl for the transportation sector in Indonesia, along with a bullish palm oil price environment in 2020.

Indonesian palm oil inventories decreased in Q4 2018, due to B20 mandate implementation and strong palm oil exports



Source: MPOB, GAPKI, Rabobank 2019

The spread between soy oil and palm oil could narrow if US-Chinese trade negotiations result in a 'no-deal'



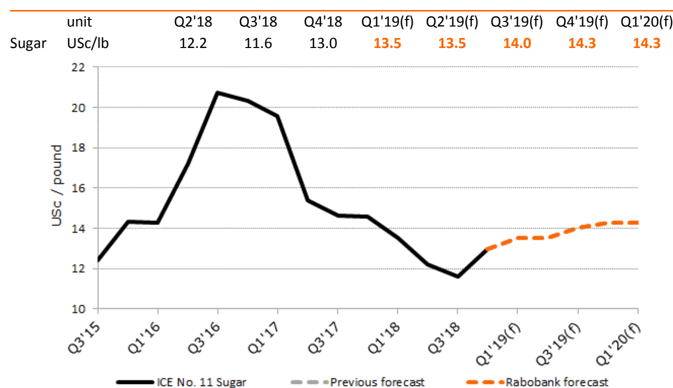
Source: Bloomberg, Rabobank 2019

Sugar

ICE #11 Sugar price forecast maintained.

- Current market prices do not incentivize sugar production in Brazil – but they will have to do so next season, starting from April.
- Weather has significantly improved in Brazil, improving the prospects for cane growth
- Australia is still being affected by drought

ICE #11 Sugar price forecast maintained



	unit	Q2'18	Q3'18	Q4'18	Q1'19(f)	Q2'19(f)	Q3'19(f)	Q4'19(f)	Q1'20(f)
Sugar	USc/lb	12.2	11.6	13.0	13.5	13.5	14.0	14.3	14.3

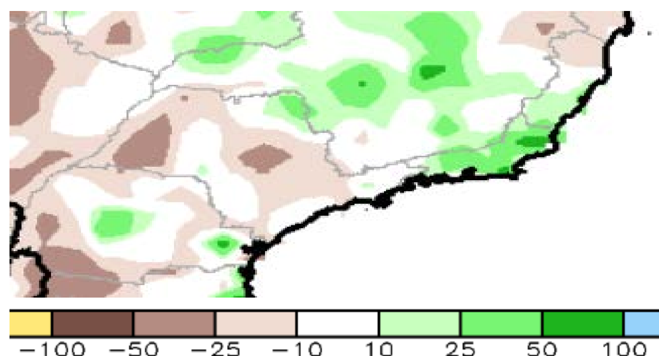
Source: Bloomberg, Rabobank 2019

Bullish forecast maintained on the ICE #11, as the active May 2019 contract sees a near 6% gain through February – taking prices closer to Rabobank's USc 13.5/lb Q1 2019 forecast. Strength was concentrated on March 2019, driving the March-May spread into positive territory for the first time in ten months. Positive signals emerged from energy markets, with active Brent crude up 10.5% MOM —food for thought for Brazilian millers as they finalise their plans for the new season´s sugar/ethanol mix. While the CFTC's Commitment of Traders catches up with the ICE #11 market developments – latest data as February 5th – Non-Commercial short-covering from a -79,271 net short will have assisted the February price rise. Rabobank continues to forecast 2H 2019 prices at +USc 14/lb, on the likelihood of a global 2019/20 global deficit. However, we anticipate trading to be contained in a short-term USc 12.5/lb-USc 13.5/lb range – as energy prices protect the downside while the threat of Indian exports continues to cap the upside.

Indian 2018/19 production is forecast to reach 30.7m mt, according to ISMA, which would represent a 4%-5% YOY decline. However, actual production figures are coming in quite strongly, with 21.9m mt of production reported from October to mid-February, i.e. 7.7% higher YOY. In any case, the prospects of heavy exports are lowered by the government's decision to raise the minimum sugar price to INR 31/kg, up from INR 29/kg, in the domestic market. The move – enabled to combat heavy cane grower arrears – could lower the propensity of mills to sell to the export market. More relevant to the longer-term price view are 2019/20 Indian sugar output prospects, where the ongoing moisture deficit is likely to drive a sharp drop in year-on-year production. Looking further ahead, elections in May, plus the increasing prospect of a WTO challenge, could represent an opportunity for changes to be made to current policy.

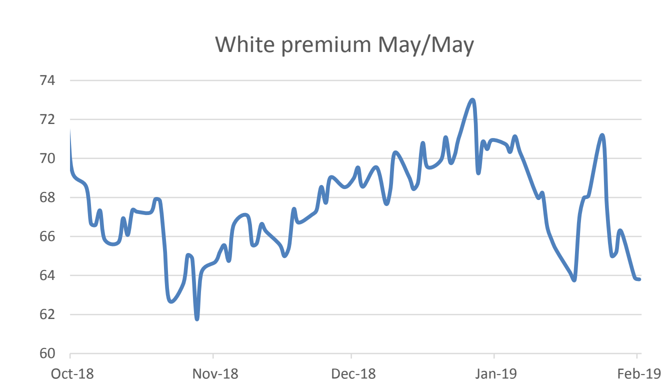
For Brazil, weather risks appear to be diminishing after Janaury dryness and heat gained market attention. Favorable rainfall in recent weeks, particularly across the state of São Paulo, should hold off any Centre-South production concerns for the time being – ahead of the harvest campaign beginning in April. Ethanol demand in Brazil is expected to become a key market driver from April. With ethanol prices rising through February –in part following international Brent prices – the ethanol parity sits at a higher USc 15.3/lb as of February 22. Meanwhile, Australian production continues to be vulnerable to the weather, with drought impacting much of the east coast through 2018, before heavy rainfall and floods hit in early 2019. The full impact of the flooding is still being assessed.

Brazil has seen significant rains over the last week, reducing the hydric deficit. 7-day rainfall anomaly (mm):



Source: NOAA, Rabobank 2019

White premium has remained volatile in the face of uncertainty in India:



Source: Bloomberg, Rabobank 2019

Coffee

We lower our price forecast as Brazil crop outlook improves.

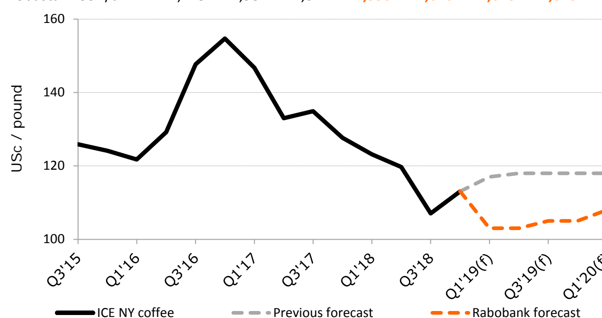
- ICE Arabica has dropped ~USc 8/lb during the first half of February, coinciding with a return of rainfall over Brazilian key areas.
- Honduran sales have improved, but are still lagging.
- Demand seems to be doing well, as stocks have increased less than expected.

Rainfall has returned to Brazil. After a very dry and hot January, rainfall has significantly increased in almost all producing areas in February. Temperatures have also significantly dropped. The rainfall has not fully replenished the hydric deficit in all areas yet, but it will certainly help trees carry their load normally, limiting any damage. Lack of rainfall only continues to be a worry in some localized areas – for example, Bahia conilon areas. More importantly, the rains will allow the trees to continue to expand branches, which will result in a higher potential for next year's crop (2020/21). In the absence of a meteorological event or a strengthening Brazilian real, we do not see much more immediate potential for a significant price increase.

Where is all the coffee going? Despite very strong exports from Brazil and Vietnam in the last seven months, stocks are not building up in destination countries. For example, US port stocks in January came in 0.08m bags lower MOM, at 6.05m bags. Also, we did not see any significant increase in stocks in Europe in December. This points to demand doing better than expected, with possibly traders and roasters choosing to build up the pipeline – especially in light of a market structure that pays to carry coffee. It is also true exports from countries like Honduras and Indonesia have been lower than a year ago, but this seems to be the result of strong competition from Brazil and Vietnam.

Arabica forecast lowered, as weather improved

	unit	Q2'18	Q3'18	Q4'18	Q1'19(f)	Q2'19(f)	Q3'19(f)	Q4'19(f)	Q1'20(f)
ICE Arabica	USc/lb	119.7	107.1	113.1	103	103	105	105	108
ICE Robusta	USD/t	1,743	1,587	1,627	1,550	1,620	1,640	1,640	1,680

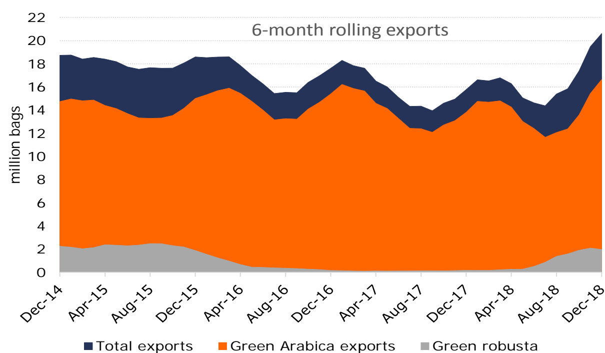


Source: Bloomberg, Rabobank 2019

The supply of milds is not seeing a sharp decline despite the low prices,,, at least not for now. Colombian January output came in 14.6% higher YOY, at 1.3m bags. Also Honduran sales have recovered a little, though they still lag behind last year's. While sales were 22% below last season by the end of January, they recovered to 16% below last season as of February 22 (with 3.2m 60-kg bags sold). The latest recovery – probably assisted by lower competition from Brazil and improved weather that allowed the crop to flow – could continue in the coming weeks, but we doubt sales will catch up with last year's record levels. This will likely be the first sign that prices are constraining arabica production outside of Brazil, the most efficient producer. How much the drop in production will be next year in Honduras and other mild producers will be key to the market going forward.

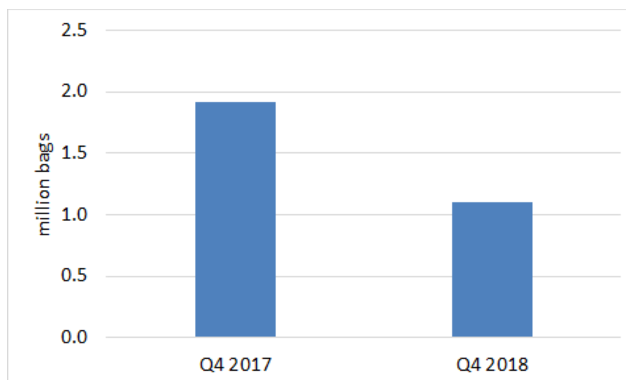
The last CFTC showed a lower-than-expected Non-Commercial arabica speculative position, at 'only' -55,235 lots as of February 5. This position is likely larger at the time of publishing this report, given the latest price developments. It is hardly surprising to see a significant speculative net short, given that we see a marked contango structure in the forward curve. The difference between March 2020 And March 2019 is 17% at the moment, which – combined with rather low implied volatility – is honey to speculative funds looking to stay short in the market.

Brazilian exports have been overwhelming – particularly green arabica exports – and will continue to pressure prices



Source: Cecafe, Rabobank 2019

Indonesian exports suffered from strong competition from Brazil and Vietnam in Q4 2018.



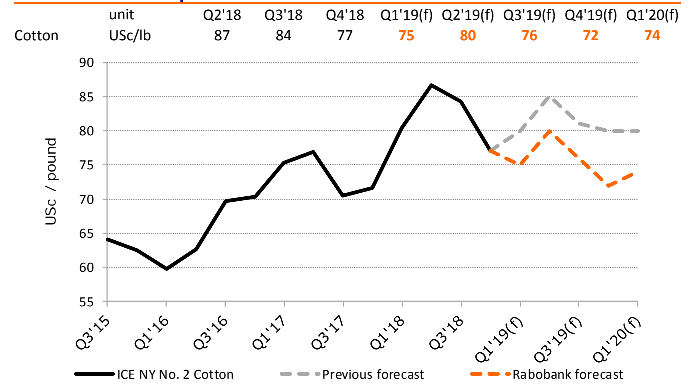
Source: ICO, Rabobank 2019

Cotton

ICE #2 prices face pressure, on both the short-term demand outlook and supply expectations for 2019.

- The USDA brings bearish news: 1. large early 2019 US area forecasts, 2. poor Chinese import demand (from the US), and 3. cuts to 2018/19 global demand growth.
- Brazil is set to plant a record 2018/19 cotton crop, with reports of a 33% YOY increase in domestic acreage.
- High early US area estimates, plus favourable southern conditions, could bring the largest crop since 2005/06.

ICE #2 Cotton forecast revised lower as 2019 fundamental outlook develops



Cotton	unit	Q2'18	Q3'18	Q4'18	Q1'19(f)	Q2'19(f)	Q3'19(f)	Q4'19(f)	Q1'20(f)
	USc/lb	87	84	77	75	80	76	72	74

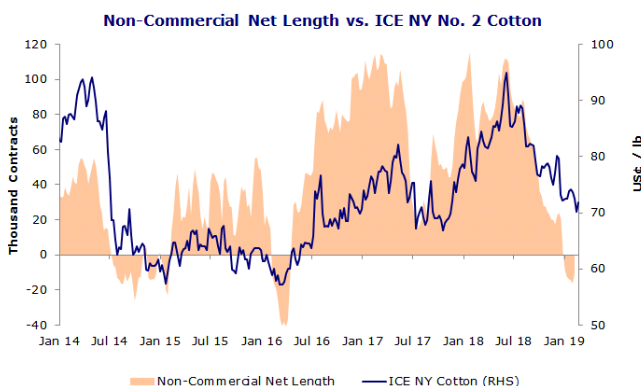
Source: Bloomberg, Rabobank 2019

Weakness remerged through February, with nearby ICE #2 prices dipping below USc 70/lb before recovering sharply into the low 70s. With USDA reports resuming, albeit still a few weeks behind, bearish revelations were abound: 1. early 2019 US acreage forecasts of 14.3m acres, 2. lacking Chinese demand for US exports, and 3. ongoing cuts to 2018/19 global demand growth. This third point is most significant by far, with slowing global growth and trade wars playing their part – the USDA now sees 2018/19 global demand growth of less than 1%, vs. Rabobank's 1%-2%, which follows demand growth of almost 6% in 2017/18. Interestingly, both China and Turkey are forecast to cut cotton use year-on-year in 2018/19. Non-commercials, as of February 5, held a net short position of –10,965 lots – near 3-year lows– as bearish sentiment prevails. As a result, we have revised our ICE #2 forecast lower across the curve month-on-month – forecasting prices at USc 75/lb through Q1 2019. Upside risks – such as a US-China trade deal, poor Indian prospects, dwindling Chinese reserve stocks, plus a weighty fund net short – remain in the short/medium term, driving Rabobank to forecast mild upside through 1H 2019.

Brazil is set to plant a record 2018/19 cotton crop, with CONAB reporting a 33% YOY increase in domestic acreage – forecast at 1.56m hectares. High prices last season, strong Chinese inquiry, and fast progression in the Brazilian soybean harvest have driven such strong acreage – the vast majority (+1m ha) being safrinha cotton in Mato Grosso. Well above the USDA's 1.45m-ha estimate, this area figure could drive a crop of 12m bales if realized – allowing for a potential 8m-bale export surplus, vs. 2017/18 exports at 4.2m bales, which keeps 2018/19 stocks stable year-on-year. These exports would likely become available late in the northern Hemisphere summer – ahead of the US picking season. While soy's early maturity (and harvest) benefited safrinha plantings, these crops are at higher risk of dryness and subsequent yield losses. Furthermore, Brazilian inland logistics remain a key challenge to the movement, and subsequent export, of 2018/19 cotton. As such, Rabobank cautions being bearish based on Brazilian 2018/19 production at this early stage – this downside risk is likely to emerge in mid-2019.

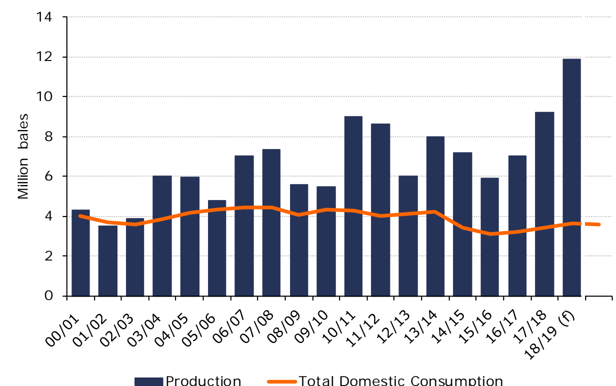
Early US forecasts from the USDA – announced at the Outlook Conference – suggest a hefty 14.3m-ac new crop – just 200,000 acres below Rabobank's November forecast. US production was forecast at some 22.5m bales – if realized, the largest crop since 2005/06. Good rainfall across the southern states – a likely impact of El Niño – will favor early plantings here. Taking into account Brazilian expansion, the longer-term supply outlook leans to the bearish side – Rabobank forecasts the ICE #2 to average USc 72/lb through Q4 2019.

Non-Commercials, as of February 5, held a -10,965 net short position – historically, funds haven't stayed short for long



Source: CFTC, Bloomberg, Rabobank 2019

A potential 33% YOY rise in Brazilian acreage could take output near 12m bales, although weather risks remain



Source: USDA, Rabobank 2019

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Methodology note: For ICE Sugar (raws and whites), ICE Arabica, ICE Robusta, and ICE Cocoa (NY and London), we aim to forecast the second rolling contracts, whereas for Palm Oil, we aim to forecast the third rolling contract. We have also used these contracts in the price diagrams. For all other contracts, we focus on the front month.

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