Coffee Outlook Q1 2019: Coping With Low Prices

Agri Commodity Markets Research

Marketing Communication

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Summary

- In March, the first contract (currently May 2019) saw the lowest level since 2005, which should result in a drop of mild washed arabica production in the future.
- The Brazilian harvest will put pressure on the market, as we believe it is larger than expected. A weakening real, at USD/BRL 3.9, combined with the prospect of another bumper crop in 2020/21, should incentivize selling.
- Given the increase in certified stocks and good Brazilian production, we do not see much price upside at the moment, barring a weather event or currency support.

The improvement in the weather in Brazil and the weakening of the Brazilian real have been the dominant forces behind arabica coffee movements in the quarter – from USc 105/lb at the end of last year to USc 95.3/lb as of March 26. As our Brazil coffee survey has shown, we expect the largest arabica off-cycle crop ever, along with a record robusta crop, so the correlation with the Brazilian real is well justified. Also, the trees are in very good shape, and could produce both a record arabica and robusta crop in 2020/21.

On the demand side, it is impressive how the large amount exported out of Brazil in the last eight months has not resulted in much higher destination stocks. We reviewed our demand numbers, and we now expect 0.7m bags' higher demand in the 2018/19 year.

Production

As anticipated in our monthly report back in January, we have increased our Brazil 2018/19 crop number by 3.8m bags, to 60.6m bags. And after our Brazil coffee survey in February, we have also increased our expectation for the 2019/20 crop, by 1.8m bags, to 57.5m bags. But alongside these changes, we have reduced our numbers in Indonesia, Colombia, Ecuador, and many Central American countries, mainly on the back of export performance or very low prices, resulting in an approximately 2.4m-bag drop in 2018/19 and 2019/20 crop years (excl. Brazil).

Colombian production decelerated in February, down by 8.7% YOY, but we think this is mainly due to the fact that the talk of minimum prices has probably been delaying sales out of Colombia. However, for the whole season 2018/19, we have to make a downward adjustment based on lower prices – from 14.2m bags to 13.7m bags. The government is likely to favor some sort of support mechanism, even if it is not detaching contracts from the 'C' price. That is our assumption for a crop above 14m bags in 2019/20.

Honduran sales continue to decelerate. Given the situation in Colombia, we would have expected more demand for Honduran coffee. But sales from October to March 25 are lagging by 21% YOY, while exports lag by 16% YOY. The increasing lag seen in March is a clear short-term response to low prices. But total exchange-certified stocks increased by

26,035 bags in the first 30 days of March – that is just over 1%. If the crop is about as large as we believe – 7m bags – the pace of certified stock build could speed later in the season, as was the case last year.

In 2019/20, we would expect to see production drops in several countries at these prices. We were expecting a large drop in Kenya, a country which did not manage to boost production during the high-price cycle – which, at the time, was combined with very strong differentials – but there are reports that the government is supplying farmers with fertilizers in an effort to increase production there. The coffee sectors in Ecuador – a country whose currency is the US dollar and where production costs are stellar – Papua New Guinea, Guatemala, El Salvador, and Nicaragua are where we would expect to see a drop in production in 2019/20. While specialty sectors will be protected by large premiums, there will be ominous prospects for the rest.

On the robusta side, we were prepared to make a sharp downward adjustment to our Indonesian production number, when there was a large upward revision to the export numbers for Lampung – an unprecedented upward revision of 38.5%. Exports are usually the one single number analysts can trust, but this is obviously not the case in Indonesia. For the time being, we drop our production estimates by 1m bags in 2018/19 and in 2019/20, to 10.8m bags and 10.6m bags, respectively. A drop in Vietnam 2019/20 is also likely, as dryness is setting in neighboring countries like Cambodia and Thailand ahead of the usual start of the wet season in the Vietnamese highlands.

Coffee Demand

As more trade data has become available, we have recently reviewed our methodology to calculate demand in many small non-producing countries. The overall result is a marginal increase in total demand, but the growth is similar: a steady annual pace of 2.0% per year between 2013/14 and 2017/18. This is just marginally below our calculated growth rate in producing countries in the period: 2.2%.

Trade statistics for Q4 2018 were expectedly good. The large amount of exports that Brazil churned out in 2H 2018 have not resulted in higher stocks in destination countries, which led us to believe in demand performing very well, probably incentivized by low prices. Net imports in the EU in Q4 2018 came in 2.9% higher YOY and 5.2% higher YOY on a 12-month basis. This is one of the highest growth rates we have on record, and it leads to an increase in our EU consumption numbers.

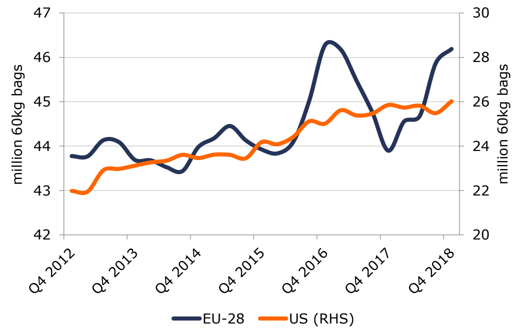
Disappearance in the US (net imports adjusted by stocks) reached record levels at 6.9m bags in the quarter and at 26.0m bags in the 2018 calendar year. Both in the EU and in the US, the annual forward yield – at over 16% – incentivizes carrying coffee by roasters at locations other than ports. Therefore, net imports are a little inflated. Still, everything seems to indicate demand is doing well.

Based on trade figures alone, we could have increased demand more in Europe and in the US, but the increase in net imports in these countries is likely not only a sign of demand reacting to low prices, but also of roasters extending the pipeline.

We can now track 35 other non-producing countries, in addition to those mentioned above (the US, the EU, and Japan). Disappearance growth in these other countries came in a little lackluster in Q4 2018, up by 1.75% YOY. This is still a healthy increase, but lower than we were expecting for the quarter.

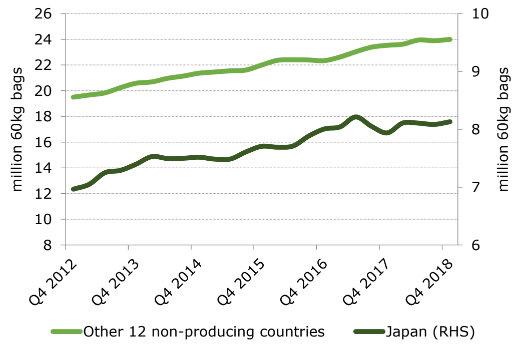
Consumption in Brazil, the second-largest market globally, has been the focus of the market. The Brazilian Coffee Industry Association (ABIC) has recently introduced a change in methodology, meaning that its consumption estimate dropped by about 2m bags, to 21m bags in the 12 months to October 2018. As we have not been adopting ABIC's number – we continue to work with 20.6m bags for the 2018 calendar year – our Brazil S/D will continue unchanged, but we foresee drops in other consumption estimates out there, maybe in tandem with lower Brazilian production estimates.

Figure 1: Annual disappearance in the EU and US, Q4 2012-Q4 2018



Source: customs data, GCA, Rabobank 2019

Figure 2: Annual disappearance in other non-producing countries, Q4 2012-Q4 2018



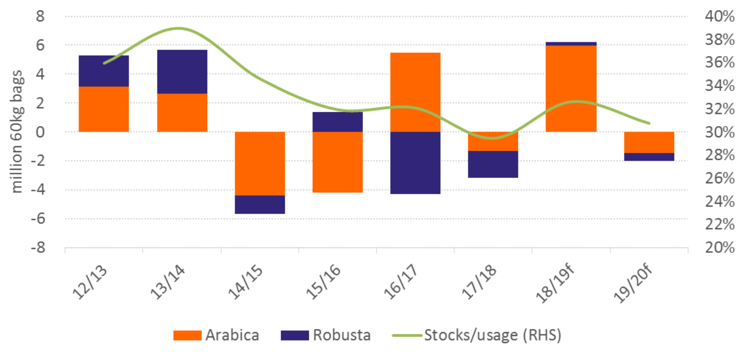
Source: customs data, Rabobank 2019

S/D Balance

We now expect a 6.2m-bag global surplus in 2018/19, of which 6m bags of arabica. As for 2019/20, we expect a 2.3m-bag deficit, mainly in arabicas. Even though 2019/20 is a deficit year, the large amount of coffee coming in the 2019/20 crop in Brazil still needs to be hedged. And the prospect of another record arabica crop is on the horizon for Brazil in 2020/21. A spike in the short term could incentivize a high volume of washed coffee to move from Central America to certified stocks – plus it would send a signal to Brazilian mills to maximize semi-washed processing during the harvest, starting from June. These two factors will almost certainly prevent the market from going to USc 120/lb in the next three months, unless there is a weather event or an appreciation of the Brazilian real.

However, the market will be wary as to how much the drop in mild washed coffee production will be in 2019/20 – and once the Brazilian harvest is mostly done, there will be a chance for the market to rise, even in the absence of weather and currency support. This will be particularly so if it rains during the Brazilian harvest, which will result in roasters returning to the mild washed coffee for quality, including the exchange-certified stocks. We currently see a stabilization or fall in the level of arabica exchange-certified stocks – or at least the expectation of it – as a pre-condition for the market to rise back above the cost of production in most mild washed producers (~USc 120/lb).

Figure 3: Global coffee S/D balance, 2012/13-2019/20f



Source: Rabobank 2019

Table 1: S/D balance (crop year), 2012/13-2018/19f*

	13/14	*14/15*	*15/16*	*16/17*	*17/18*	*18/19f*	*19/20f*
Production	**153.9**	**144.8**	**151.3**	**158.5**	**157.3**	**170.2**	**165.2**
Brazil	56.1	49.4	50.0	54.0	49.2	60.6	57.5
Vietnam	27.5	26.5	28.4	26.3	29.8	31.1	29.3
Indonesia	12.9	11.0	12.8	12.4	11.6	10.8	10.6
Colombia	12.1	13.3	14.0	14.6	13.8	13.7	14.1
Other	45.3	44.6	46.2	51.2	52.9	54.0	53.7
Demand	**148.2**	**150.5**	**154.2**	**157.3**	**160.5**	**164.0**	**167.5**
Non-producing countries (Oct-Sep)	103.4	104.9	107.6	109.8	111.7	113.7	115.7
Producing countries (crop year)	44.8	45.6	46.6	47.5	48.8	50.2	51.72
S/D balance	**5.7**	**-5.7**	**-2.8**	**1.2**	**-3.2**	**6.2**	**-2.3**
Of which arabica	2.7	-4.4	-4.2	5.5	-1.3	6.0	-1.8
Of which robusta	3.0	-1.3	1.4	-4.3	-1.9	0.3	-0.5
Share of robusta in non-producing countries	36.2%	36.1%	36.1%	35.2%	34.0%	34.0%	34.0%

* Figures denote million 60kg bags.

Source: Rabobank 2019

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A summary of the methodology can be found on our website www.rabobank.com