

Agriculturals | Coffee

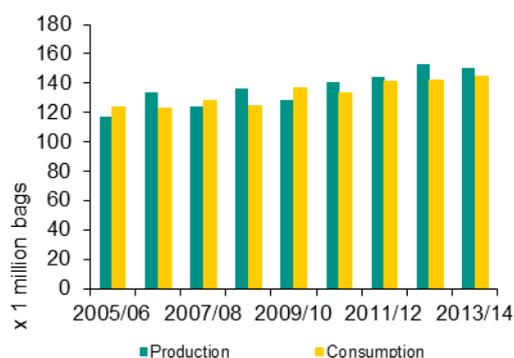
- **Impressive rally due to weather-related events, which pushed down crop expectations**
- **More upward potential for Arabica in the coming months**
- **Robusta supported by Arabica strength but capped by origin resistance**

Historical price coffee



Source: Thomson Reuters Datastream

Coffee: production and consumption



Source: USDA

Group Economics price forecast (Cts/lb) 3-m price end of quarter and year averages

	3-month	2014	2015	2016
Arabica	230	200	-	-

Source: ABN AMRO

Weather events resulted in major rally

Coffee was, by far, the best-performing commodity with a more than 85% rally in the first quarter of 2014. In our previous update, we expected a bottoming-out phase for Arabica coffee prices as Brazilian rains hurt crop expectations. However, the situation changed completely thereafter. Due to the severe and unprecedented hot and dry weather in Brazil during January, February and March, coffee crop forecasts were cut back significantly, resulting in an impressive rally. Arabica prices more than doubled from a low of USDc 100/lb to over USDc 210/lb. In January and February, rainfall levels were more than 60% below the longer term averages. In March, rainfall was 40% below normal. April levels appear to be above the longer-term average, but this cannot unwind the damage already done. Initial market estimates were for a record Brazilian crop of more than 55 million bags. Now even the lowest estimates have been cut back to 40 million bags, although this is seen as unrealistic. The harvest starts in May/June. Only then will the actual impact of the drought on this season's crop be crystallised.

Impact to be felt in years ahead

As a result of the strong rally, Arabica became even more expensive than Robusta, with the mutual relationship (arb) rising to a recent high of USDc 108/lb. The sharply changing story compared to the start of the year resulted in the fund positions on Arabica switching from being significantly short to long. Robusta funds were already long, thus changing the arbitrage outlook. As a result of the recent significant rally in coffee prices, the roaster community is likely to increase their commercial prices so retail consumers will probably be confronted soon with higher coffee prices in supermarkets. The market's direction will remain strongly weather-dependent. As the winter will start soon in Brazil, the risk of more negative weather-related news cannot be ruled out in the form of cold spells and frost. Therefore, some more upside in Arabica coffee prices can be expected in the near term. For the next three months, a target price in the range of USDc 220-240/lb seems plausible. We have significantly raised our 2014 average price for Arabica to USDc 200/lb. Price developments for Robusta will strongly depend on the outlook for Arabica. If there is further support for Arabica, Robusta prices are likely to follow higher. Expectations for a near record crop in Vietnam are being confirmed by excellent shipment numbers, while the Indonesian crop may somewhat disappoint. In line with the Arabica development, Robusta prices could gain another USD 100-200 towards our price target of USD 2350.

In addition to the impact on the 2014-15 crop year, the following year's Brazil crop will be affected as a result of the unseasonal dryness. For 2015-16, an 'off-year' in the cycle, a significant reduction will be seen in the crop size although this is really an unquantifiable number right now. The impact on this years' crop may be dampened somewhat by the large carryover stocks, but this will not help the 2015-16 supply and demand picture. The impact on the subsequent crop years is impossible to gauge as there is no historical precedent for this atypical weather event.

Upside to the forecast:

- Indonesian crop reductions
- Lack of rainfall in Brazil
- Brazilian Arabica output

Downside to the forecast:

- Downturn in the global economy
- A spill-over from negative sentiment towards commodities if other asset classes are seen as a better investment