Cocoa price set to increase

From January to May, the price of cocoa increased by more than 50%. The main driver of the surge was high demand at relatively low prices. The low prices were chiefly due to the historically high supply in the 2016/2017 season. Cocoa beans were able to grow well thanks to favorable weather conditions. All-in-all, this resulted in a record harvest in the 2016/2017 season and prices dropped to levels we had not seen in ten years. However, since the 2018 price peak in May, prices have softened again and we are left with the question of how much we should expect to pay for cocoa in the future.

Figure 1: Price of cocoa versus price volatility

Source: Thomson Reuters Datastream, ABN AMRO

Chocolate lovers have a lot to thank to Casparus van Houten and his son Coenraad for. In 1828, the Dutch family applied for the exclusive right to a more cost-effective process for pressing the fat from roasted cocoa beans. The final result of the complicated process Van Houten developed – which is also referred to as 'Dutching' – was a soluble brown powder. His invention has made a major contribution to the growth of the cocoa industry in the Netherlands since that time. And the Netherlands is still a leading country in the cocoa industry. While cocoa beans are mainly harvested in Ivory Coast and Ghana, the Netherlands is the largest importer of cocoa beans in the world. Besides processing cocoa, Dutch cocoa companies export many of the imported cocoa beans to neighbouring countries directly. As a result, the Dutch trade in cocoa beans is also of significant size.

Demand remains robust

Cocoa is a popular consumer product. Per capita consumption has been the highest in Europe for years. The Swiss eat the most chocolate in the world. On average, the Swiss per capita consumption is about 10 kilos per person per year. The Netherlands ranks

<table>
<thead>
<tr>
<th>Cocoa</th>
<th>% price opposite to 1 January 2018</th>
<th>% price opposite to 1 week ago</th>
<th>% price opposite to 1 month ago</th>
<th>% price opposite to 3 months ago</th>
<th>Price volatility over last month (avg.)</th>
<th>Price volatility over 2018 (avg.)</th>
<th>Price volatility since 2000 (avg.)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>+13.4%</td>
<td>-3.3%</td>
<td>-4.0%</td>
<td>-7.2%</td>
<td>11.2%</td>
<td>11.3%</td>
<td>10.5%</td>
</tr>
</tbody>
</table>

Volatility is the average difference between highest and lowest price in mentioned period (calculated on 1 months moving averages)
eighth in per capita consumption, with nearly 5 kilos of chocolate consumed per person per year. In recent years, the consumption of cocoa in emerging countries has also increased at a remarkably strong pace. In countries such as China, Indonesia and India, per capita consumption is still relatively low, sometimes even below 0.5 kilos per capita. This indicates that the potential for further growth in demand in these countries is high. This year, the import of cocoa into China increased by 16%, while the import of cocoa in Indonesia grew by 2% year-on-year. The number of grindings of cocoa beans – a good indication of the demand for cocoa – is also increasing sharply. Until the third quarter of 2018, the number of grindings in Asia had increased by 8.4% year-on-year.

**Figure 2: Import coca and grindings cocoa in Asia**

Source: Thomson Reuters Datastream, CAA

Demand in Europe also remains robust, but the figures are less impressive than those in Asia. In Western Europe, the number of grindings of cocoa beans in the first three quarters of this year increased by 5% year-on-year. That said, cocoa product manufacturing activity is growing much less fast. Up to September, production in Europe had increased by only 0.5% year-on-year. In the US, imports of cocoa beans dropped by 23% year-on-year in the same period. That may not sound like a positive start to the year, but in August and September of this year imports of cocoa picked up again, rising sharply after twelve long months of contraction.

**Supply remains sufficient**

Weather conditions in West Africa were favorable for the growth of the cocoa beans: enough sun and not much rain, so that fungi and diseases had little chance of developing. This means that supply remains robust, which has a depressing effect on the price of cocoa. Globally, there is no shortage of cocoa beans. The International Cocoa Organization (ICCO) expects there to be a surplus of 31,000 tons for the 2017/2018 season. That is just under 1% of the total number of cocoa grindings and 6%-points lower than the 2016/2017 record harvest season. ICCO estimates the stocks-to-grinding ratio at 38.5% this season, i.e. 1%-point below the long-term average since 2008. The number of grindings has increased by nearly 30% since 2008, while inventories have increased by less than 13% in the same period. This results in a lower stocks-to-grindings ratio. This often points to higher prices going forward since fewer cocoa beans are available. As a result, there is less powder on the market. This forms an incentive for grinders to expand their capacity in order to meet demand. Furthermore, the announced fixed farm gate prices by Ivory Coast and Ghana will result in a guaranteed price for farmers. The minimum farm gate price also ensures that farmers are less tempted to switch to another crop (such as palm oil).
The cocoa price quoted in London has lost ground due to the political turmoil regarding Brexit. After it became clear that resistance against the exit agreement was increasing, the pound Sterling fell against both the euro and the dollar. In the short term, uncertainty will remain high and the volatility of the pound Sterling – and that of the cocoa price – will increase. The policy of the US central bank (the Fed) will also cause a fair amount of unrest. The Fed is expected to raise interest rates again in December and that will result in a stronger dollar against the euro. This will put pressure on the cocoa price, which is also traded in dollars internationally. However, ABN AMRO believes that the dollar will weaken again in 2019, landing at around the EUR/USD 1.25 mark at year-end 2019. This will have an upward effect on cocoa prices. Speculation also plays a role in price direction and volatility. The number of long positions among producers, traders, processors and users has increased since June this year, at the expense of short positions. This would indicate that they too expect higher prices.

However, the strong fluctuations in the price of cocoa do not translate directly into the consumer price for chocolate. Many chocolate producers have hedged price volatility or have concluded long-term contracts. As a result, producers do not have to pass on the short-term price changes to end users. Moreover, the international cocoa price is only one of many factors that determines the selling price of the final product.

ABN AMRO believes that the price of cocoa will increase in the long term. The demand for cocoa will remain robust, especially with the growth potential for Asia and other emerging markets being very high. This provides a good basis for stronger prices. On the other hand, the pace of growth in demand in developed economies is weakening and this trend will continue in the coming years. Developments in harvest and total supply over the longer term remain unclear. However, supply is exposed to all sorts of disruptions and other developments that can strongly influence quantities. In this sense, it is important to consider factors such as the influence of weather phenomenon El Niño on harvests (less favorable weather conditions with fungi and diseases as a result), the aging of trees (at the expense of the quality of the cocoa beans), the emergence in the cocoa industry of countries such as Peru, Brazil and Chile, and the decrease in investments (resulting in a decrease in areas planted with cocoa trees). Lastly, the political instability of large cocoa-producing countries is of great influence as well.
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**Graphical Insights**

**Price (USD/Mt)**

- Cocoa Daily Price
- CSCE-COCOA 2nd contract

**Price volatility versus LT-average (in %)**

**Open interest versus price (USD/Mt)**

- Open interest
- Cacao prijs

**ICE cocoa total stocks (bags)**

**Grindings Western Europe (in % yoy)**

**Production cocoa products Europe (in % yoy)**

Sources: Thomson Reuters Datastream, ECA, CAA, ABN AMRO

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