

Agri Commodity Insights – Coffee

Price of coffee follows Brazilian real

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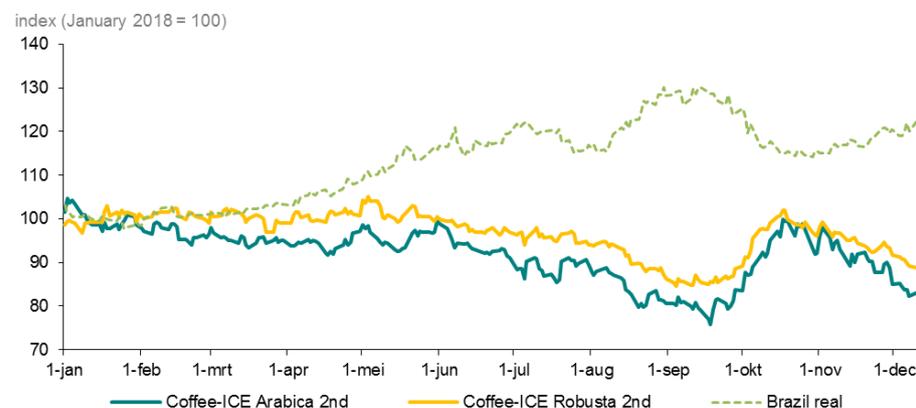
Coffee

10-12-2018	3m %
- Coffee (Brazil, NY) spot price (USDc/lb)	103.07 2.6%
- Coffee (Colombia, Ara NY) spot price (USDc/lb)	130.50 0.4%
- Coffee (Arabica ICE US) 2nd contract (USDc/lb)	105.15 3.9%
- Coffee (ICO Robusta NY) spot price (USDc/lb)	82.50 3.6%
- Coffee (Robusta NY) 2nd contract (USD/Mt)	1,548 4.8%

Exchange rates

10-dec 2019	2019 eop
- EUR/USD	1.14 1.25
- USD/BRL	3.93 3.20
- EUR/GBP	0.89 0.86

Coffee prices fell from January to September 2018, with the price of Arabica decreasing by 25%, while Robusta lost 14% of its value. In October, prices recovered thanks to the strong appreciation of the Brazilian real and an improvement in demand. Within a short time, prices nearly reached the level of 1 January. But since 17 October, prices are in a downtrend again due to sufficient supply. In light of this, what can we expect next for coffee prices?

Figure 1: Price of coffee in 2018 (Arabica versus Robusta) and Brazilian real


Source: Thomson Reuters Datastream

There are numerous factors behind the volatility in coffee prices. Weather is frequently mentioned as a deterioration in the weather can easily lead to disappointing yields. This creates supply disruptions and increases price volatility. Weather conditions close to the equator are particularly important to monitor, because coffee plants traditionally grow best in that area. Brazil, Colombia, Vietnam and Indonesia are the four largest coffee bean producing countries. But there are also substantial harvests in Africa, in such countries as Ethiopia and Uganda. In all these regions, soil conditions are of great importance. Coffee thrives best in soils that are well drained, allowing the roots to go vertical and horizontal. In addition, the soil should preferably be loamy, comprised of equal parts sand, silt and clay. And coffee plants will also thrive if the soil is rich in organic matter and cultivated on slopes in the north, east or northeast, assuming there is sufficient shade. In any case, a (sub) tropical climate is preferable, with the right variety of wet and dry periods. All in all, coffee plants are rather challenging to grow, and touchy when it comes to weather conditions. Hence, volatile weather patterns cause volatile coffee prices.

Trend in coffee price (Arabica and Robusta, 2nd contract):

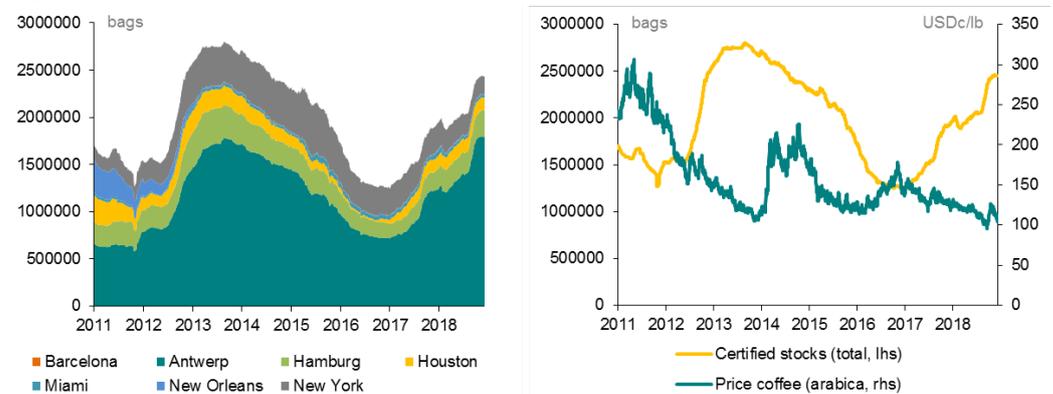
	% price opposite to 1 January 2018	% price opposite to 1 week ago	% price opposite to 1 month ago	% price opposite to 3 months ago	Price volatility over last month (avg.)	Price volatility over 2018 (avg.)	Price volatility since 2000 (avg.)
Arabica	-15.7%	-2.5%	-10.5%	+3.9%	11.2%	8.6%	11.2%
Robusta	-10.5%	-2.6%	-8.1%	+4.8%	6.9%	6.0%	8.8%

Volatility is the average difference between highest and lowest price in mentioned period (calculated on 1 months moving averages)

Rising demand for and supply of coffee

The trends in demand, supply and inventories are also important price-determining factors. Due to good yields in the 2017/2018 harvest year, global stocks of coffee have risen sharply. This has led to price pressure in 2018.

Figure 2: Stocks by region versus price of Arabica coffee



Source: Thomson Reuters Datastream

In Antwerp – which has the largest inventory of coffee in the world – stocks have risen by 44% since the beginning of this year. Hamburg, which also has large coffee stocks, has also seen a 28% increase in volumes this year. While coffee availability is good in Europe, stocks are decreasing in North America. In Miami, New Orleans and New York, stocks have fallen by an average of 37% since the beginning of 2018, while in Houston the level of inventories has remained almost stable over the same period. On balance, global inventories have increased by 24% since 1 January 2018 and this improvement in the availability of coffee has had a downward effect on prices.

Demand for coffee is good, especially for Brazilian coffee beans. According to the International Coffee Organization (ICO), total coffee exports have risen by 2% in the 2017/2018 season. In the period 2013-2017, the average growth in the global demand for coffee was 1.6%, with above-average demand growth in Asia and North America. In Europe, average growth in demand is 1% on an annual basis. Expectations for the growth in demand remain good. Because coffee prices are relatively low, the growth in demand will be stronger than average in the coming year.

Coffee output will also continue to be good. The coffee harvest has a biennial cycle. This means that a season with a good harvest (the 'on'-year), will be followed by a season with a lower harvest (the 'off'-year). In Brazil, the coming season will be an on-year and the harvest is expected to come out higher compared to the 2017/2018 season. This ensures that the availability of coffee will remain stable. According to the US Department of Agriculture (USDA), the global oversupply of coffee will be 8 million bags of coffee in 2018/2019, which is approximately 5% of total consumption. As a result, global stocks will increase.

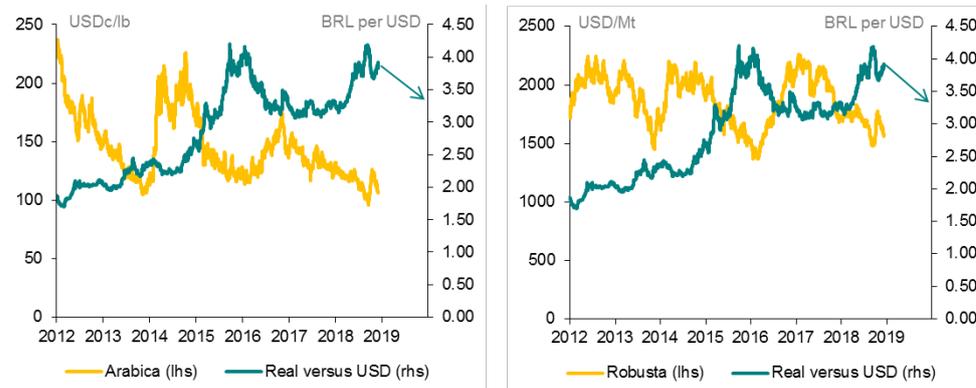
Coffee price strongly driven by Brazilian real

Approximately 35% of the global supply of coffee beans comes from Brazil and the trend in the Brazilian real therefore has a strong influence on coffee prices. In the period from January to August, the real fell by more than 25%. This was caused by the trade dispute between the US and China and the stronger dollar. This was followed by a recovery period and the real rose 6% until early December. The recovery was fueled by a decline in the

electoral uncertainty in Brazil, optimism among investors about possible reforms and, ultimately, the election victory of Jair Bolsonaro.

For 2019, ABN AMRO foresees a stronger real against the dollar, mainly due to US economic policy and a more favourable investment climate for emerging markets. Our USD/BRL forecast for year-end 2019 is 3.4.

Figure 3: Price of Arabica and Robusta versus Brazilian Real



Source: Thomson Reuters Datastream

The coffee price will rise due to the stronger real as coffee is largely traded in dollars on international markets. The stronger real makes coffee less valuable and that gives traders in Brazil an incentive to sell less in international markets in anticipation of higher prices. As a result, the availability of coffee in external markets decreases and this will have an upward effect on prices.

The trend in speculator positions (or the so-called 'Commitment of Traders') also has a strong impact on coffee prices. The number of short positions has declined sharply since the end of September on short covering. This means that speculator sentiment regarding the coffee price has improved and speculators assume that the price pressure on coffee will decrease. This is largely based on the expectations concerning the Brazilian real and a stronger demand for coffee at the current relatively low price. However, there is still a chance that funds will re-engage their short positions again as soon as uncertainty about the global economic climate increases.

On balance, an upward price trend but at a slow pace

We expect higher coffee prices in 2019, although the increase will remain limited. The growth potential for demand is high in the coming year given the relatively low coffee price. As the demand for coffee grows above average in international markets, the price will trend upward in 2019. We think, however, that good availability will cap this upward trend in prices. Still, this capping effect will be offset by the upward trend in the Brazilian real. Our forecast for a stronger real until the end of 2019 will contribute to the upward trend in coffee prices. But the upward trend will be insufficient to fully compensate for the price loss in 2018. This means that the average price of Arabica coffee in 2019 (USDc 112/lb) will be lower than the average Arabica coffee price in 2018 (USDc 117/lb year-to-date).

Upward effect on price:

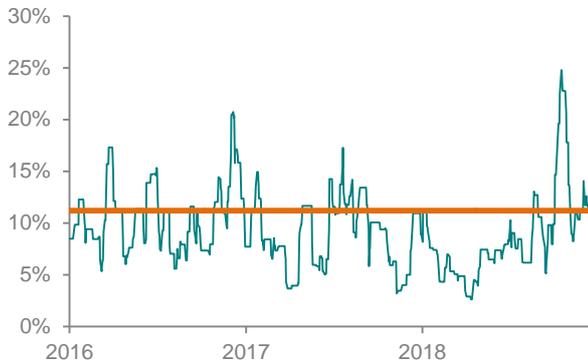
- El Niño (lower supply on heavy rainfall, drought in Asia)
- Lower yields
- Stronger growth demand emerging markets
- Long term: stronger real eop 2019

Downward effect on price:

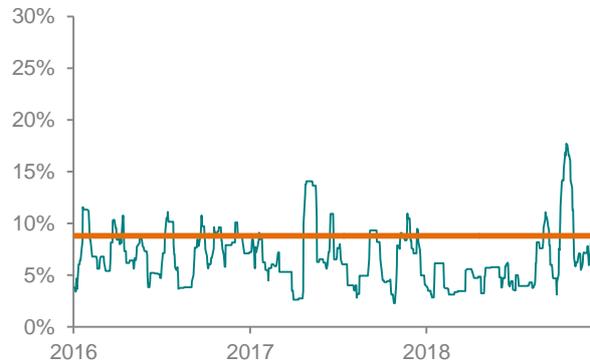
- Higher output Brazil ('on'- year in biennial cycle)
- Sufficient supply and high stock levels globally
- Short term: rate hike Fed, with stronger dollar
- Decrease pace of demand growth in developed countries

Graphical Insights

Price volatility Arabica (in %)



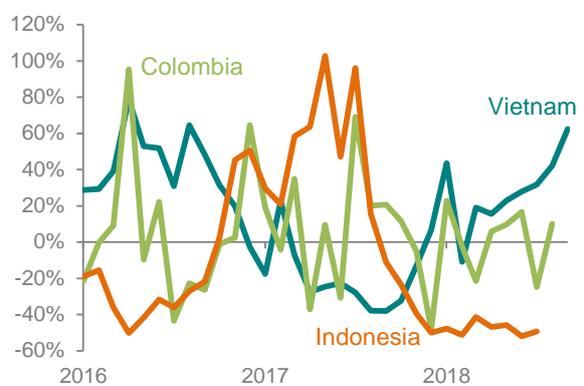
Price volatility Robusta (in %)



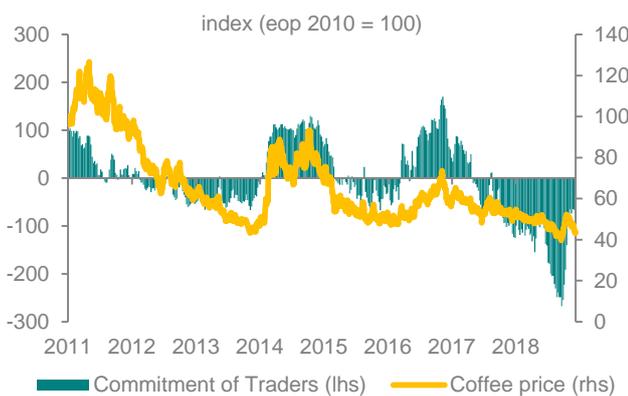
Production Brazil: roasting and grinding (% yoy)



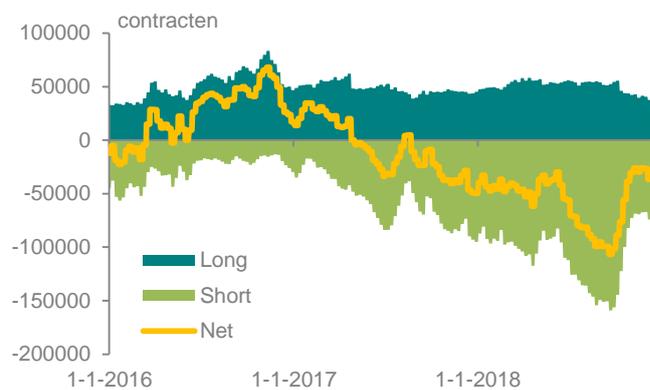
Export Vietnam, Colombia, Indonesia (% yoy)



Commitment of Traders versus price



Commitment of Traders (non-commercial)



Sources: Thomson Reuters Datastream, ABN AMRO

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