Backgrounder on Sugar Supply Situation -- January 2020

The 2019-20 sugar marketing year is just a quarter of the way over, but the remaining three quarters have the potential to test the resolve of the sweetener industry, both producers and users, as never before. Lower North American sugar production, as well as in several other key regions of the world, portend to tighten supply and boost prices. Domestically, U.S. sugar production is forecast down 9% from 2018-19 due mostly to crop disasters in two key producing regions. At the same time, Canadian beet sugar production is down about 45% due to the same weather situation as in the United States, and outturn in Mexico is forecast down 10% from a year earlier.

Based on the above situation and as further explained below, the United States should increase imports of high-polarity (99.8 or above) refined sugar for direct use by U.S. food manufacturers by at least 300,000 tons, raw value, in the remainder of 2019-20. Further, approval of those imports should occur as early as possible in the marketing year to avoid shortages in the April-August period.

In the United States, the country's largest sugar seller, United Sugars Corp., declared force majeure in November 2019, alerting its customers that it would be unable to deliver 18% of the supply it had already sold for delivery in 2019-20. However, United delivered 100% of their sales during the October-December quarter as planned, with the 18% annual reduction spread over just nine months, which in effect makes the reduction in the last three quarters of 2019-20 equal to 24%. United, which sells both beet and cane sugar, is the largest refined sugar seller in the United States.

The Western Sugar Cooperative also declared force majeure in November, alerting its customers that it would be unable to deliver 15% of its sales in 2019-20. Like United, Western fully delivered its October-December commitments with the reduction applied to the January-September period. Thus, Western's deliveries will be reduced by 20% during the final three quarters of 2019-20. Western accounts for about 5% of U.S. sugar supply. On January 21, Western informed its customers that it would cut another 5% from its deliveries, bringing its total shortfall to 20%, upping the nine-month cut to 27%.

Restricted shipments from both companies began on January 1, 2020.

The U.S.D.A., in its January World Agricultural Supply and Demand Estimates report, forecast U.S. 2019-20 sugar production at 8,158,000 short tons, raw value, down 841,000 tons, or 9%, from 2018-19 and down 1,135,000 tons, or 12%, from record production of 9,293,000 tons in 2017-18.

Production in Mexico has been forecast at 5,772,000 tonnes, actual weight, down 10% from 2018-19 due to drought in key producing regions, especially along the Gulf of Mexico, which is the key region shipping raw sugar to the United States. The cane harvest began slowly and was running 27% behind the prior year's pace through Jan. 4. "The current pace of the harvest suggests that there may be downward pressure on the current production forecast. Given the potential for reduced supplies in Mexico, as well as increased U.S. Needs, constrained availability of sugar for export could become an issue for the current fiscal year," the U.S.D.A. said in its January 16 Sugar and Sweeteners Outlook.

Mexico's harvest and sugar production typically gain momentum in January and peak during the late winter months. The slow start to the harvest means potential shipments to the United States likely will be delayed, or at a minimum, will not be able to be moved forward to offset the U.S. deficit which may begin to be realized as early as in the January-March quarter this year.

While Mexico is the first option to supply the U.S. market as outlined in the agreements suspending the antidumping and countervailing duties on U.S. imports of sugar from Mexico, and it has said it will fill the U.S. Needs, it should be noted that circumstances are quite different from the last time Mexico exported such a large volume of sugar to the United States. That was in 2012-13 and 2013-14 when Mexico exported about 1,926,000 tonnes each year (prompting U.S. producers to file antidumping and countervailing duty charges against Mexico). But, Mexico had massively excess sugar supply after record-large production of nearly 7 million tonnes in 2012-13 with an ending stocks-to-total-use ratio of about 22%. This year, Mexico's sugar production is forecast at 5,772,000 tonnes, (and expected to decline), down 17% from that record year, with a stocks-to-use ratio of 15%. Refined sugar prices in Mexico in December 2012 were 33.55c per lb and declining, compared with 41.77c in December 2019.

Canadian beet producers, concentrated in Alberta, lost about 45% of their crop due to freezing weather during harvest. Domestic beet sugar accounts for 6% to 10% of total Canadian refined sugar production of about 1.2 million tonnes (about 15% of U.S. production), with the rest coming from raw cane imports. Sources of Canada raw cane imports vary year-to-year, but from 70% to more than 80% come from South America, from 15% to 25% from Central America, from practically none to 10% from Mexico and a fraction from other countries. While there should be no direct impact on the United States due to the losses of beet sugar outturn in Canada, refiners indicated they will make up the loss with increased imports of raw cane, which will further tighten the global supply from the most nearby origins (Central and South America) should the United States need additional imports from the world market.

The world sugar market is expected to be a deficit situation in 2019-20, with forecasts ranging widely from about 6 million to 10 million tonnes, raw value. Lower production in Brazil, India, Thailand, Australia, the European Union, Mexico and the United States all contributed to the swing from a small global surplus in 2018-19 to a deficit. While global sugar supplies and prices usually do not have a significant effect on U.S. sugar supply and prices because of the U.S. Sugar Program, if the United States needs supply from countries other than Mexico, it may be more difficult to source this year.

While "on paper" it appears sugar from Mexico and/or globally may be adequate (albeit tight) to meet U.S. needs, the greater concern may be structural. If U.S. imports arrive in their normal pattern, there are questions as to whether U.S. cane refiners have the capacity to process all the raw sugar that is needed this season. There are two traditional refiners (Domino and Imperial) that rely on raw sugar imports for the bulk of their refining supply. Beet sugar deliveries typically are strongest from October through May as processors work through beet piles. This year, beet processors' campaigns will end at least a month early because of the reduced 2019 sugar beet crop. Cane refiners typically pick up the slack from June through September with large supplements of imported raws. Cane refiners don't have the storage capacity to build up large inventories of refined sugar during the "off months" of January through May, and it would add significant costs to do so. Any unused capacity is "lost" during that time.

As a result, it would seem prudent to increase imports of high-polarity refined sugar early in the year. Sugar users have indicated that any refined sugar imports with polarity below 99.8 must be further processed, which would not help the U.S. refining capacity issue. Imports of 99.8 polarity or above can be directly used by U.S. food manufacturers. Approving such imports early in the year is critical as some estimate that it would take up to a month to get refined sugar from Mexico (for example) to a final Midwest destination, such as Chicago. If the supply came from Mexico, the sale must be negotiated, transportation arranged, export license issued, bags of sugar broken into bulk rail cars, transit times of

10 to 17 days, testing, unloading, etc. Further, some suspect that Mexican mills may not be ready sellers as they see only upside potential to pricing due to the U.S. dilemma and tightness in Mexico.

High-tier imports are another option but come with similar time requirements.

Under current projections from the January WASDE, the United States needs an additional 100,000 tons of sugar to pull the ending stocks-to-use ratio from 12.7% up to the minimum required 13.5%. It would make sense for all of that to be high-polarity refined sugar. But would that be adequate should Mexico fall short of its projections, and accounting for shortfalls that always occur? An additional 245,000 tons (345,000 tons total) would bring ending stocks to 1,901,000 tons and the ending stocks-to-use ratio up to 15.5% without threat of oversupply. The ending stocks-to-use ratio has been over 15.5% two of the last four years, keeping U.S. sugar prices in check in the low 30c-per-lb range, while ensuring an adequate sugar supply. It would make sense for all of the additional 345,000 tons of sugar to be 99.8 polarity or above to allow direct use by U.S. food manufacturers, thus reducing the threat of exceeding the available U.S. cane refining capacity in the remainder of 2019-20.