FALCON COFFEES

Fortnightly Report

April 27, 2021

THE BULLS

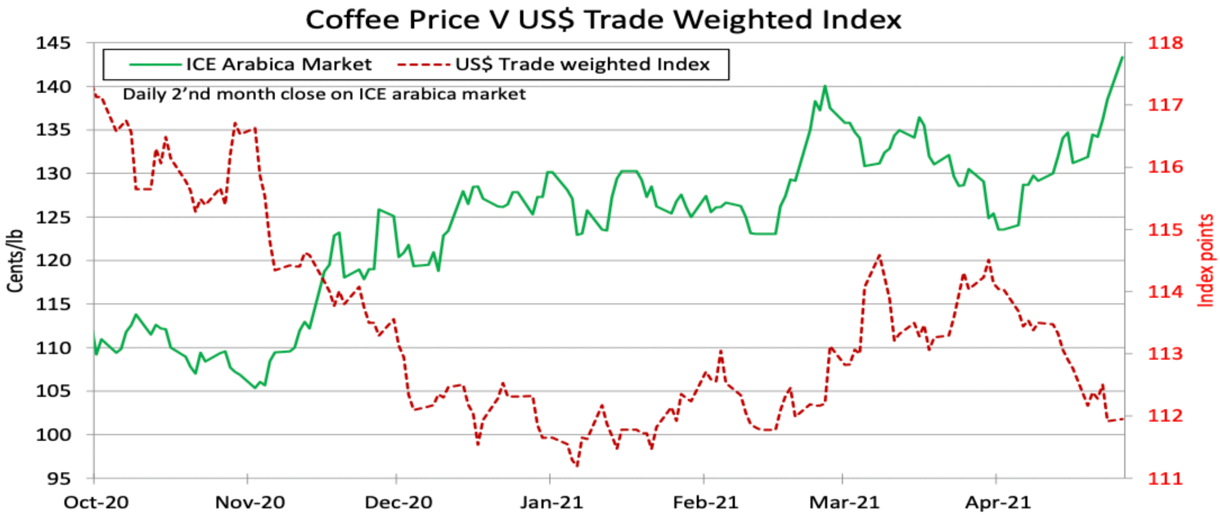
- Prices broke through resistance on Apr 26th to close at >3-year highs.
- FOB diffs for Mild coffees remain firm with Honduran HG coffee trading at around +17c/lb and Colombia Excelso at +50c/lb.
- Brazilian farmers have sold over 90% of 20/21 crop and at least 35% of 21/22 crop.
- The consensus is that the next Brazil arabica crop will be 30-40% lower.
- There is increasing concern about dry weather in Brazil arabica areas. Some farmers already reporting smaller screens, defects, and smaller branch on-growth.
- Rains have been below normal in Brazil arabica areas since mid-March.
- Estimates for a shortfall in arabica supply in 21/22 crop year vary from 7.5 to 10m bags.
- Freight problems have eased in Vietnam but difficulties and container shortages have been reported in Central America and Brazil.
- Acute shortage of spot Vietnamese robustas in importing markets, with withdrawals from robusta certs at 90,000 bags in April.
- IMF forecast predicting strong global growth in rest of 2021 with the US powering ahead on fiscal stimulus and successful vaccination program.
- Exchange rates changes helping coffee prices. The US Dollar (USD) has weakened against most major currencies.

THE BEARS

- Roasters added 15,862 lots to their price coverage below 130c/lb, though COT report shows it was reduced by 10,754 lots as prices moved back above 130c/lb.
- Roasters have comfortable near-by coverage and are unwilling to make large forward purchases.
- Brazil exports remain high, and exporters see little new roaster demand.
- Arabica certs continue to rise, with stocks increasing by 71,000 bags in March and by 57,600 bags in April to 23rd of month.
- Withdrawals from arabica certs have been very small in April.
- Withdrawals from certs, USA disappearance and European and Japanese imports are all indicating that roasters usage of coffee has been poor in last 3/4 months.
- New Covid-19 strains and a further round of lockdowns have made the prospects for European growth and future coffee consumption in 2021 uncertain.

Note:- bag refers to bags of 60 kg unless specifically mentioned.

COFFEE BREAKS OUT OF LONG TERM RANGE



MARKET REVIEW

- The ICE arabica market posted a strong recovery over the last three weeks. Having fallen to a low of 122.50c/lb on Apr 5th prices steadily rallied up through technical resistance at 130c/lb and up to the much stronger resistance at 140.00. Jul21 briefly traded at a high of 140.20c/lb on Apr 23rd before breaking more decisively above on Apr 26th to close at 143.35 vs Jul21, the highest close since August 2017.
- The Commitment of Traders (COT) report for Apr 20th shows the funds holding a comparatively small net long position of 17,733 lots. The funds have plenty of scope to buy the market, as the net long position on Apr 20th is 18,552 lots below the position they held in February.
- Bullish sentiment has undoubtedly been underpinned by trade reports forecasting a substantial deficit of arabica supply against demand in the 21/22 crop year. However, the rally has as much been driven by factors external to coffee, including improved economic sentiment around global growth and the decline of the US Dollar (USD) against a basket of currencies. USD weakness has been reflected in a close correlation between movements in arabica futures and a number of other USD-denominated soft commodity markets, such as cotton, sugar and lumber. Importantly for coffee the Brazilian real (BRL) has shown more stability moving to below BRL5.50 vs the greenback.
- While the previous price rally in February was capped by origin selling as the market moved towards 140 c/lb it is unlikely that origins might be as active again in the current market rise. The COT report shows that origins are already well covered having price-fixed 5,682 lots in the week to Apr 20th, as the market moved towards 135c/lb. The commercial short position of 190,093 lots on Apr 20th was just under 13,000 lots larger than on Feb 16th, when the market began its previous move higher.
- The belief that arabica origins are well sold is backed up by trade estimates from individual regions. Brokers in Central America estimate that around 80% of the current crop there has been sold. In Brazil, analysts Safras & Mercado report that 90% of the current crop has been sold. It is more difficult to get forward sales estimates for the 21/22 and 22/23 crops but estimates in Brazil are that well over 35% of the 21/22 crop and some 15% of the 22/23 crop have been sold forward. Brazilian farmers can also afford to wait for even higher prices as they are well financed, following a year with a record crop and high prices, and well aware of the production problems ahead.

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- If we did see a big surge in sales out of Brazil it would indicate that traders have got the supply situation completely wrong, so that either the 21/22 arabica crop forecasts are too low, or there is a much larger stock carry-over than has been considered. Current conditions in the internal market indicates that the supply forecasts are correct as traded volumes are low with a BRL20-30/bag gap between where exporters are prepared to buy and where farmers are willing to sell, despite farmgate prices for soft cupping coffee rising to BRL770/bag (106.5c/lb), close to or above the record prices seen in February.
- Spreads between the nearby contracts have hardly moved during the market rise, with Jul21 continuing to trade at a premium of around 1.85-1.90c/lb against Sep21. This premium would fall, and even reverse, in a market where coffee was truly in tight supply. The longer dated spreads, however, have come in during April with the premium of the Jul21 contract over the Jul22 contract falling from an 8.0-8.25c/lb range in the first week of the month down to 7.25c/lb on Apr 23rd. A sign that the market is anticipating a tightening of supply in the longer-term.

STOCKS & DEMAND

- The behaviour of the spread, along with various other indicators shows that in the short-run trade and industry have a plentiful supply of arabica coffee. Brazil exports remain high, with the country exporting an estimated 36.7m (60kg) bags of arabica coffee in the 12 months to March 2021, 4.4m bags more than in the year to March 2020. Roasters are well covered for their nearby Brazil requirements and exporters report very little interest in new sales at current price levels. Colombia shipped 7.1m bags of coffee in the first half of its 20/21 crop year (which runs from October to September), 0.2m bags more than in the equivalent period of the previous year. Central American exports are still lagging behind their level in the 19/20 crop year, but shipments have been strong in the Jan-Mar quarter of 2021.
- The rate has slowed, but Brazilian semi-washed coffee has continued to be graded against the ICE arabica contract. Arabica certs have increased by 57,600 bags in April, with a certified stock level of 1.90m bags on the 23rd of the month and 56,700 bags pending grading. Industry also seems to have little appetite for the older, time-discounted Central American certs.
- The slow withdrawal from the arabica certs is not surprising given that they are overwhelmingly warehoused in European ports where demand remains comparatively slow. Hopes are on the US as the key area to spark a resurgence of coffee demand, due to the success of their vaccination program and the level of fiscal stimulus to the economy. Statistics compiled by the Green Coffee Association (GCA) show US port stocks falling by 111,000 bags in March. Port stocks at end-March 2021 of 5.79m bags were 0.35m below their level in the previous year.
- While GCA stock decline is viewed as a positive indicator the fall in stocks, at least in the first two months of 2021, seems more connected to a decline in US imports, rather than any immediate sign of a pick-up in demand.

ORIGINS

- There is increasing concern in Brazil about the impact of a prolonged dry spell in April and the second half of March in the main arabica growing areas. A cold front brought some rains back into the area on Apr 18th, but the rainfall was less than forecast and April rainfall in the key producing region of South Minas is running around half its normal level.

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It has been even drier in the Cerrado, although in this region most farms are irrigated. Only isolated thunder showers are forecast for the arabica areas in the last week of April, and longer-term forecasts indicate that the dry spell will continue in the first half of May. This means that there is a good possibility that the arabica areas of Brazil will enter the dry season from the end of May with depleted soil moisture reserves. The dry weather might also cause lower screen sizes. It is difficult without a proper survey to really gauge the impact of this on 21/22 production, but it will need to be watched closely during the harvest season. It is also possible that the dry spell has reduced the on-growth for the 22/23 crop.

ROBUSTAS

- The Jul21 contract on the LIFFE robusta market increased by US$59/tonne, 4.3%, in April, closing at US$1,416/tonne on April 23rd. The arbitrage between the Jul21 arabica contract and the Jul21 robusta contact widened out to 74c/lb on Apr 23rd, compared to 63c/lb at the end of March due to the comparatively anaemic performance of robusta. The high premium of arabica futures over robusta futures does pose the question whether there can be a shift to more robusta usage in the rest of 2021. There is no sign of this at present and it looks unlikely given the problems in shipping robustas out of Vietnam.
- Conilon grading against LIFFE resumed in April, with just under 120,000 bags graded to the 23rd. This must be coffee shipped some time ago, as very little conilons have been shipped into the main ports holding certified coffee since November. There has been demand for the older time-discounted robusta certs given the shortage of spot Vietnamese robusta stocks in importing countries, with Vietnam reducing its green coffee exports by 2.9m bags in the first half of the 20/21 coffee year. It is calculated that 90,000 bags of coffee had been withdrawn from the robusta certs during April, the biggest draw since June.
- It is reported that the freight problems are easing in Vietnam and exports increasing, although vessel and container availability are still not guaranteed. Conilon differentials have remained surprisingly firm at around + US$100/tonne, despite the start of a large new harvest, although as yet little new crop coffee has reached exporters There are reports that there are increasing freight and container problems in Vitoria, the main port for shipping robustas out of Brazil.