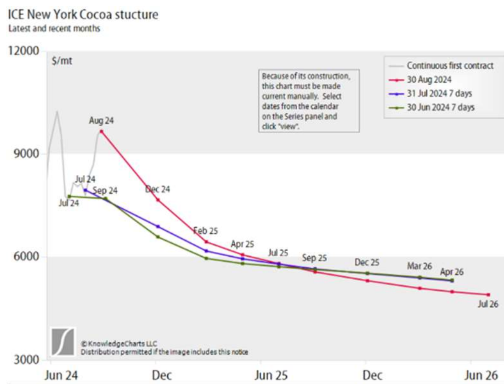
Market Update

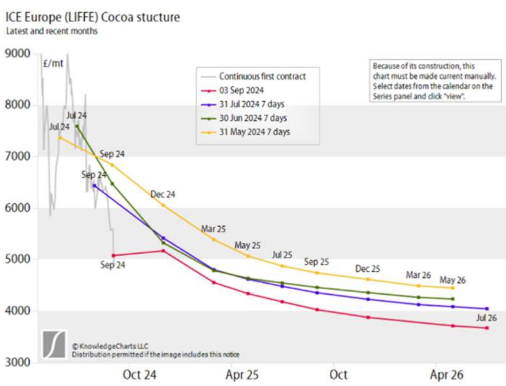
September 2024

Front Terminal Spread Hits Historic High: What's Happening and What's Next?

The cocoa market is experiencing significant movement as the spread between the Sep'24 and Dec'24 contracts in New York reaches a record high of USD 2,000. Following the expiration of the July contract, the spread (UZ spread) initially rose to about USD 1,000 but surged to USD 2,000 as the expiration approached. This spike is driven by arbitrage opportunities and a shortage of cocoa beans in London, making the New York Sep'24 contract the most affordable option on the market.



Initially, it was expected that most participants would export beans from New York Exchange to the Europe market to meet the EUDR deadline. However, on September's First Notice Day (FND), fewer than 3,000 MT were changed hand—significantly below expectations. Does this indicate a lack of interest in the cocoa beans on the NY exchange, or are there limitations preventing the transfer of beans from NY to the EU exchange?



While New York faces intense pressure with a large front spread, the EU cocoa market shows a different trend. After the July contract expired, the spread between Sep'24 and Dec'24 (UZ spread) has narrowed significantly, from GBP 1,000 to GBP 250. In the first week of Sep, the UZ spread further narrowed to a GBP 100 discount. A carry market usually signals a surplus of beans, raising questions about what's going on with EU exchange stocks.

With physical cocoa in short supply, beans are likely to be allocated to areas with the highest demand rather than being held back for arbitrage opportunities. The current performance of the terminal is somewhat disconnected from reality and doesn't fully reflect the actual market situation.

Now, let's dive into the bigger picture of the cocoa market, which is navigating a tricky period marked by a significant shortage, fluctuating prices, and a complex interplay of influencing factors.

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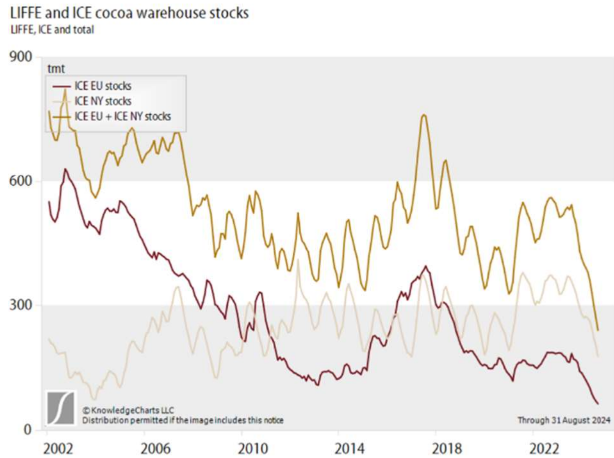
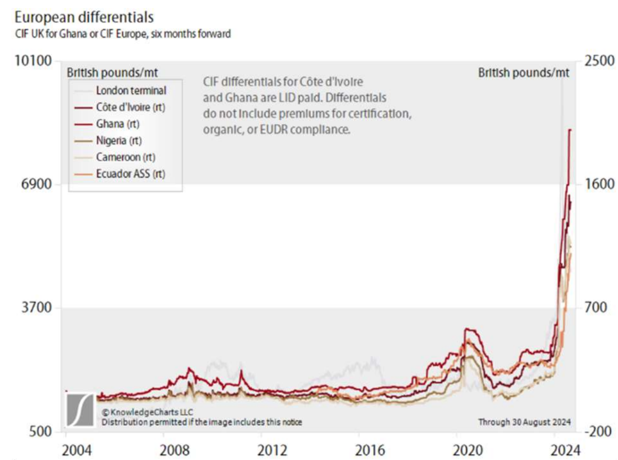
What's Driving the Current Cocoa Bean Sourcing Crisis and Its Impact on the Product Market?

The current cocoa bean sourcing crisis is driven by drastically reduced production in Ivory Coast and Ghana. Since June 2024, Ivory Coast has restricted bean exports to ensure local supply. The ICCO has raised its global cocoa deficit forecast for the 2023/24 season (Oct-Sep) to 462,000 metric tons, up from 439,000 metric tons. Buyers are scrambling to secure beans from other origins, as forward sales contracts were largely settled a year ago. This rush has driven differentials to historic highs, exacerbated by rampant smuggling and overpayment in various regions.





In the past two terminal months, market participants have drawn heavily from exchange stocks, leading to historically low warehouse levels—around 60,000 metric tons, compared to the usual 300,000 to 400,000 metric tons. This scarcity is putting immense pressure on short-sellers to cover their positions, tightening supply and escalating market tension.

Pricing and differentials have surged as players scramble for fresh, high-quality beans to maintain product standards. European buyers are paying premiums to secure early deliveries from origin before the year-end to meet the EUDR deadline. This causes high differential and creates an unfavorable situation to deliver bean to exchange.

The market's direction is uncertain: Will the 24/25 new crop be ready for Dec'24 tender? Will differentials align with tender parity? How will those rushing to secure beans ahead of the EUDR deadline manage in this volatile market? And what impact will the expiration of non-EUDR-compliant beans in Dec'24 have on market dynamics? The situation is full of uncertainties, making it challenging to provide a clear outlook.

Cocoa processors typically buy beans well in advance from the front terminal and sell against forward contracts. However, the current bean shortage has disrupted this process, leading to historically high differentials and overpayments. This has caused a surge in the cost ratio—the relationship between raw material costs and final product prices—since the beginning of the year. The tight bean supply has intensified pressure on the product market, creating a ripple effect throughout the industry.

Looking Ahead: Market Outlook and Key Considerations

It's crucial to identify the key drivers of chocolate demand for next year. Recent results from chocolate producers suggest that rising prices are affecting demand, though the full extent of this impact is still unclear. Factors such as high cocoa costs, a shift towards products with lower cocoa butter content, and changes in recipes to use more cocoa butter substitutes are likely to shape future demand.

We look forward to seeing you at the upcoming CAA event. Have a safe journey, and see you in Singapore!