JBCOCOA

Market Update

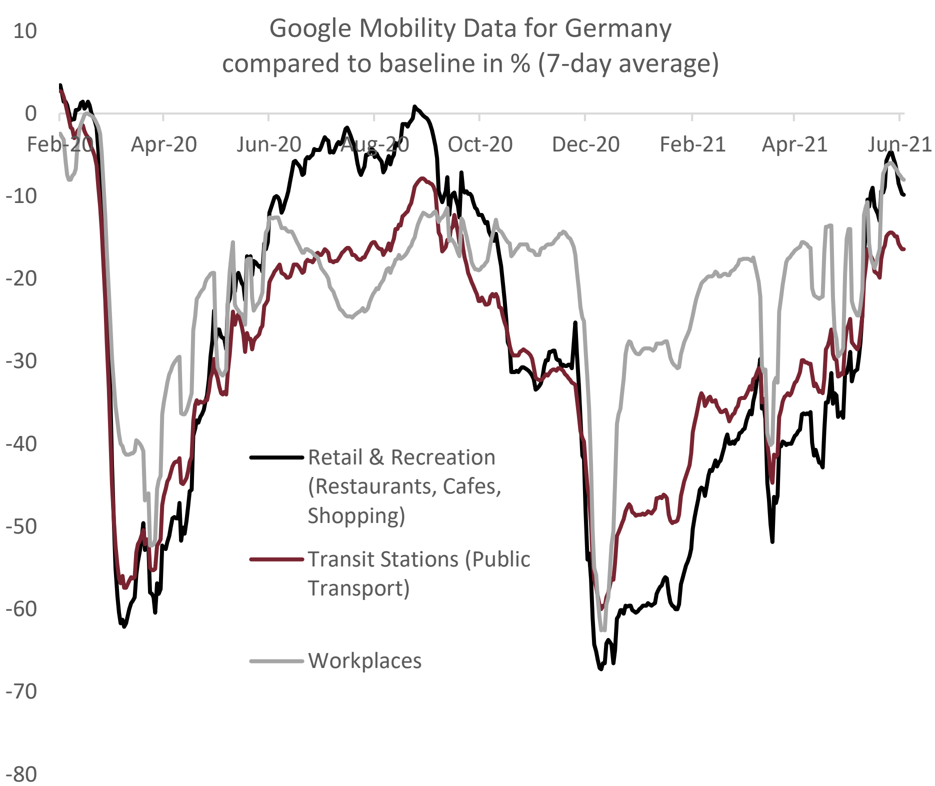
June 2021

Why we might soon pay more for Freight than for Beans

The world is quickly emerging from the pandemic thanks to successful vaccination campaigns. Demand for cocoa products has picked up well but cocoa prices remain depressed. Instead logistics costs have skyrocketed and supply chains have broken down. Hence prices at destination will increase while prices at origins remain depressed.

Opening Up

Most developed countries have seen Covid cases dropping and have opened up their economies. People are again traveling, eating out and commuting to work (chart below). This has not only helped chocolate sales but also business confidence has returned. As vaccination campaigns are picking up in many developing countries (Brazil, India, Mexico; page 2), demand and confidence will continue to improve.



As expected, this has led to an increase in cocoa product prices, especially for 2021, where supply from Ivory Coast has been constrained due to power shortages. However, cocoa bean prices have continued to erode, both for futures and differentials. This has been bad news for Ivory Coast and Ghana, that are well behind in their sales for the upcoming season and which had hoped that the end of the pandemic would help them to achieve better prices for their beans.

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A record production is one of the reason for depressed cocoa prices despite a rebound in demand. Based on current trends, Ivory Coast will finish the 20/21 season with an all-time record crop of 2.3m tons and Ghana is well on track to break through the 1m barrier. In addition to ample production for the current season, the outlook for the new season has improved greatly thanks to the return of strong rains and a confirmed uptrend in the crops.

In addition, the introduction of the LID has made the bean differential more controversial and sticky. Market expectations of ever lower differentials have meant that buyers have been slow in buying despite the rebound in demand. Moreover, power shortages in Ivory Coast have led to a 35% drop in grindings during May and a similar shortfall is expected for the month of June. Only in July or August might electricity supply be sufficient to meet demand in the country, and there remain questions on whether this issue could be more structural and longer lasting. With the slowdown in local grind, factories have been slower in their purchases and once again farmers have been struggling to sell their beans, with underpayments of the official farmgate price (CFA 750/kg = USD 1360/mt) common. A backlog at the ports is further slowing down exports and hence purchases. While increasing freight rates mean that bean buyers are demanding lower FOB prices to compensate for higher freight and logistics costs.

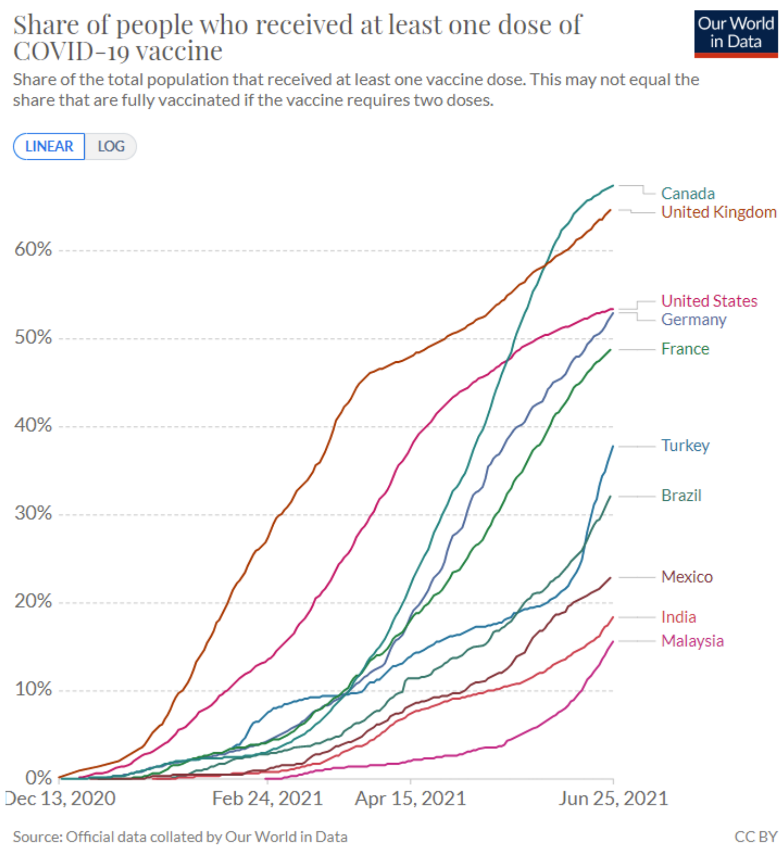

Figure 1, Emerging economies catching up quickly

Figure 2, 20ft rates East Asia to North America East Coast

Freight Rates going through the Roof

However, the freight situation is far worse for shipments coming from East Asia and going to Europe or North America. Quotations are now as high as USD 15,000 for a 20ft container from East Asia to the US East Coast. Even higher than the chart on the right which is showing the sharp increase from about USD 2,500 in 2020 to above USD 10,000. Based on freight rates of USD 15,000 and 20 tons in a 20ft container, it now costs USD 750 per ton to ship cocoa products from Asia to the US. Thus, while the cocoa farmer receives often less than USD 1,360 per ton, shipping lines are already earning up to USD 750 per ton. In addition to record freight rates, logistics cost for trucking, warehousing, handling have moved up due competition for warehousing space from e-commerce companies such as Amazon.

High freight rates would normally benefit cocoa processing at origin, as it involves the least transits and lowest logistics costs. However, as mentioned, due to power shortages in Ivory Coast the local factories have been unable to take advantage of this situation. It seems therefore inevitable that product prices at destination for both butter and powder will rise to pay for higher freight and logistics costs. As participants have been reluctant to book shipments at higher rates, they have been drawing down product stocks at destination. In addition, backlogs and lack of vessel space are leading to further delays in shipment for both for beans and products. As demand picks up further there is a risk of tightness in the product market for the traditional peak season in the fourth quarter (Christmas). Grindings in North America and Europe are expected to be strong in order to compensate for the shortfall of products from West Africa. Moreover, destination grind has gained competitiveness compared to product imports from Asia thanks to record freight rates.

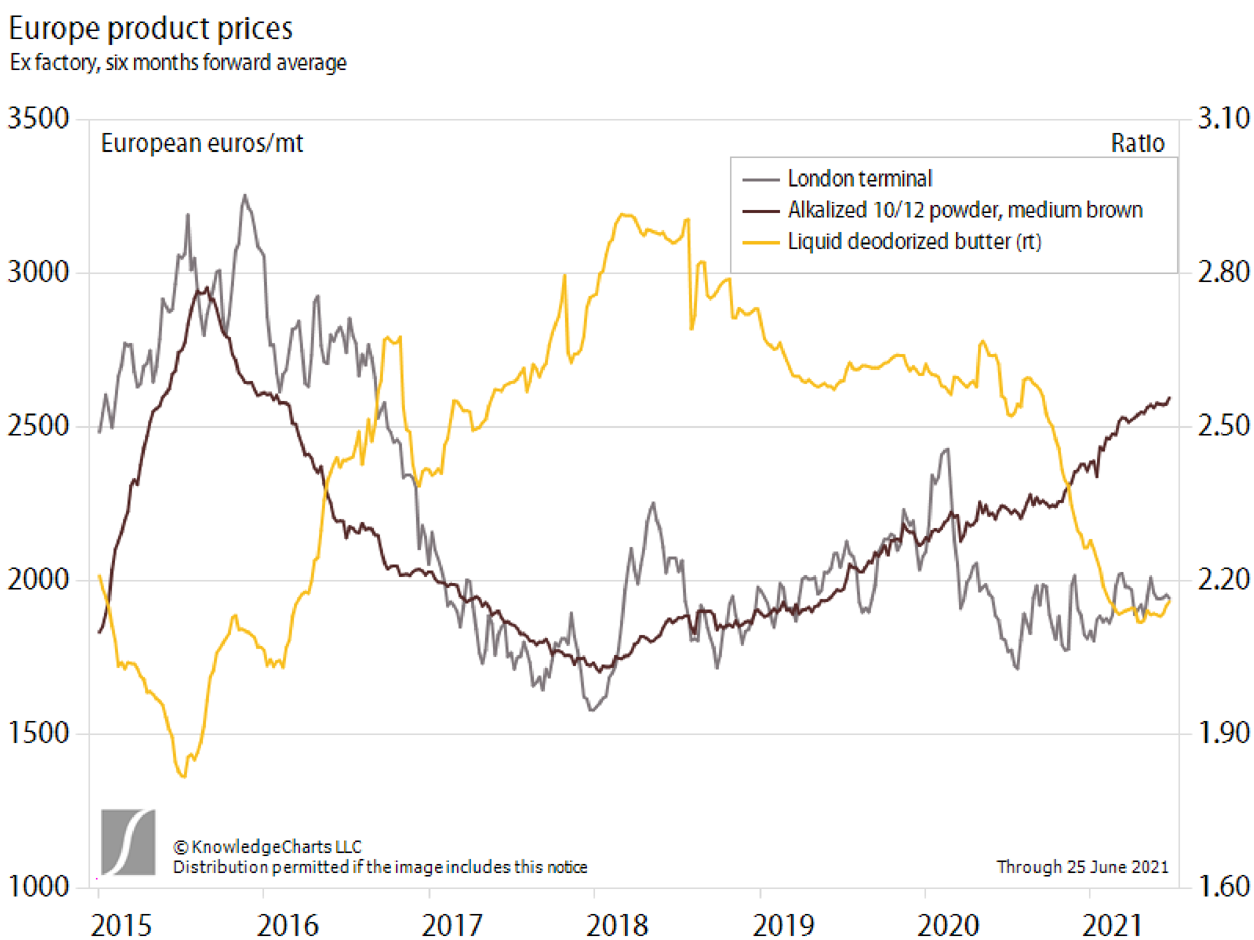

Figure 3, powder prices remain high while butter ratios have bottomed out

Conclusion

Despite strong grindings expected for the remainder of 2021, futures and differentials are likely to remain cheap as the current surplus is weighing on the market. We see record bean stocks in the US and a carry structure well into 2022. Funds have taken this as a signal to sell cocoa according to recent COT data. Bean differentials will remain cheap until the backlog at the origin is resolved, both in terms of operations (logistics/electricity) as well as forward sales. Product prices at destination will rise as demand is expected to accelerate with the rollout of the vaccination campaign and as supply chain costs continue to increase during 2021. Given the size of the global container backlog and the time it takes to add new vessel capacity, there is unlikely to be much improvement before 2022 or even 2023. Cocoa prices can remain depressed as long as weather remains favorable and unsold cocoa continues to cap any upside. In the longer term however, current prices look attractive historically, especially given the inflationary pressure in most other commodities and sectors.

ICE Cocoa in dollars and the CRB

Second position