

The world recovers: Part 1

By Ed Jernigan, FC Stone

After the turmoil in world financial and equity markets in the second half of 2008, and the associated retreat of commodity prices, commodities have stabilised and even rallied over the past few months.

World turns from abyss

Much of this renewed optimism stems from the range of stimulus packages employed in most major economies, and especially in China. The massive “shovel-ready” stimulus of the Chinese economy certainly seems to be working as evidenced by:

- Urban fixed asset investment is up by 29.6 per cent in the January-April 2009 period;
- Automobile sales have reached record levels;
- The Purchasing Manager’s Index showed growth in April; and,
- Retail sales have expanded.

China: Retail Sales versus World Sales

This Chinese growth is impacting commodities worldwide. For example, in April Chinese imports of soybean, copper, iron and other imports soared — the Baltic Dry Freight Index reached its highest level since early October 2008. Other Asian countries such as Taiwan, South Korea, Indonesia and Vietnam have been major beneficiaries and the impact will flow through to other economies.



Ed Jernigan.

COTTON

Although cotton has enjoyed a rally in recent months, the rally has stalled as prices reach 62 cents.

Even so, cotton enjoyed a 40 per cent price appreciation from the November 2008 lows.

The main reasons for such a strong rally were:

- The previous price decline was an over-reaction;

- Global retailers/mills drew down inventories in the fourth quarter of 2008;
- Government support schemes in China and India worked.

What is cotton’s outlook from here?

World consumption is again expected to exceed production in 2009–10. This means there will be less cushion for any supply problems around the world and a good chance of stronger markets on the back of problems in major production areas (Figure 1).

In China, stocks are expected to tighten in 2009–10 as production declines. In fact, Chinese cotton production may have peaked with large areas of East China moving to grains.

Chinese cotton area is expected to be down by 12 to 15 per cent and consumption is expected to exceed production by 10 to 11 million bales. The shortfall will be covered via liquidation of cotton reserve stocks and imports. The imports will come in spurts as quotas are released.

As production falls, retail offtake of apparel is increasing at a rate of 15 to 20 per cent.

Elsewhere, 2009–10 cotton production set to fall in Central Asia, Turkey and the African Franc Zone, while it is expected to increase in India

GRAINS: CORN/SOYBEANS MOVE HIGHER, WHEAT DULL

Corn

US corn stocks are set to tighten. USDA 2008–09 ending stocks will be 1.600 billion bushels and are predicted to fall to 1.145 billion bushels in 2009–10.

But yields and acreage are still in doubt. If there is a one million-acre loss and yields are the same as 2008, it would mean a US carryover of only 850 million bushels.

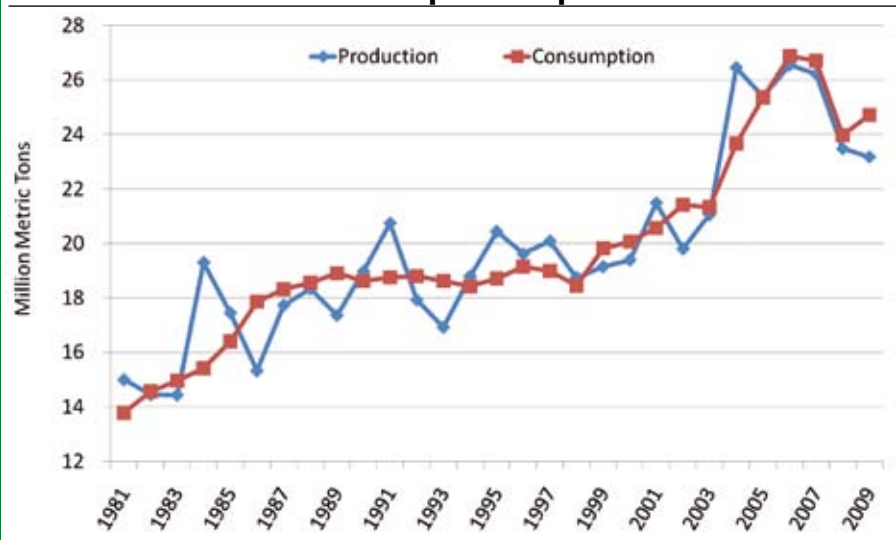
World stocks are also expected to tighten.

Soybeans

Chinese 2008–09 soybean imports have been very strong and could reach 38 to 39 million tonnes. The USDA projects imports will expand even more in 2009–10.

China only produces 15 to 16 million tonnes versus 51 to 54 million tonnes of consumption.

FIGURE 1: New cotton consumption vs. production



The drought in Argentina has adversely impacted soybean production from that region. The USDA May estimate was 34.0 million tonnes, but private estimates put production even lower at 31 to 32 million tonnes. Similarly, private estimates put both US and world ending stocks of soybeans well below the USDA May estimate.

While corn and soybeans enjoy very tight scenarios, wheat faces oversupply prospects.

Wheat

The USDA April forecast for 2008–09 global wheat demand was 646.33 million tonnes, which was revised down to 635.70 million tonnes in May. In 2009–10, demand is only forecast to increase to 642.77 million tonnes.

In India, the second largest producer in world, 2008–09 production should be a near record of 77.63 million tons and stocks could reach 30 million tons (40 per cent of consumption).

World wheat ending stocks are expected to increase from 167.05 million tonnes in 2008–09 to 181.90 million tonnes in 2009–10 (Figure 2).

Australian wheat output is expected to reach 23 million tons in 2009–10, up from 21.5 in 2008–09 and 10.822 in 2006–07 (Figure 3).

COMMODITY OUTLOOK

The upside for commodities will depend on supply issues in 2009–10 and 2010–11. The key overriding macro influences are that China and developing Asia will lead world growth, while the US may be slow to recover and European economic growth will remain a drag.

This focus of growth in the commodity-consuming nations means agricultural commodity prices will continue to find support on any substantial weakness (Figure 4).

Don't forget the food crisis of 2008.



FIGURE 2: World wheat ending stocks in million tonnes (1988–2009)

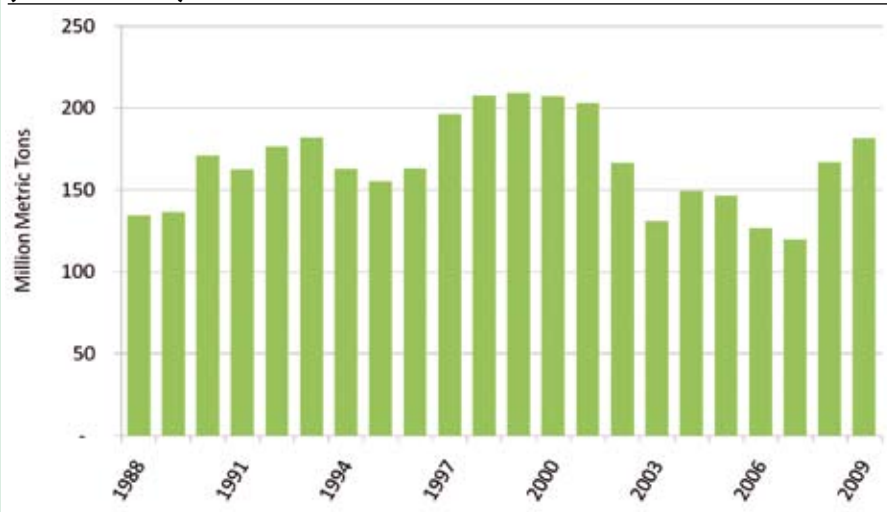


FIGURE 3: Australian wheat production (in thousand tonnes)

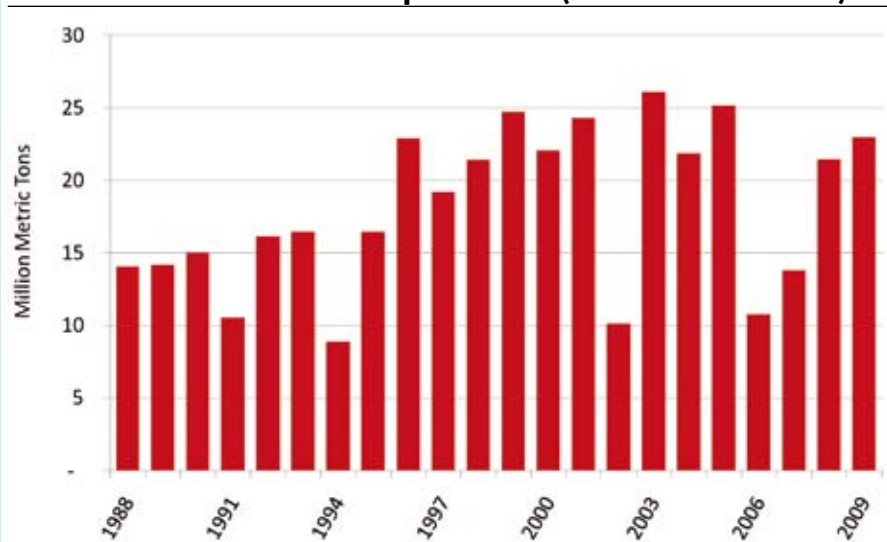


FIGURE 4: Commodity prices rally as demand improves

