

Bounce, Bounce, Zoom? Or Plop?
By Meghan Sapp

In the past six weeks, world sugar prices have gone from amazing heights not seen for 30 years to slumping back down 10 cents (or \$200, depending if one looks to New York or London) in a massive sell off. Mysterious sugar production has suddenly appeared in India, the Europeans are exporting again, profits were taken and many fled when it became apparent the record breaking had run its course.

Or has it?

Despite assurances from the Indian government that this year's sugar production will be almost two million tonnes higher than recently thought—perhaps eliminating the need for more imports immediately—the world is still very much in a deficit market. Sure, the Brazilians are crushing longer and more than ever before and perhaps these new Indian estimates are accurate, but FO Licht is still saying there's at least 7 million tonnes missing from this season's crop.

The American sugarbeet crop is secure for at least the next season and likely through 2011 thanks to a Federal District Court decision to hold off on banning GMO seed, but Mexico is likely lying about its ability to produce enough sugar to stay off more imports and bring down its skyrocketing prices that make the recent world records look cheap as chips. But this is all fundamentals, the reason why the market balances itself out with supply and demand, and that has nothing to do with what's set to happen any minute now.

And that's bounce.

Already Thursday markets were beginning to show signs of a reversal in prices. Raw sugar settled up 3.6% and whites settled up 2%. Though that's nothing compared to the 40% drop seen in recent weeks, that's enough to get some eyebrows raised and some shorts covered in a hurry. The fortunes that have been lost (and made) in recent weeks may just as quickly be erased.

With everyone looking to figure out what direction the market will go, the immediate bets seem to be on "up." At least to 19 cents, as was seen in Thursday's trading, likely to 21 cents to complete a "head and shoulders" technical move and perhaps as high as 23 cents. Even Goldman Sachs, who's right about everything (except for the Greek economy), says that sugar is more comfortable at 20 cents than anything else. The scramble to cover shorts has begun, which will keep fundamental traders—and more importantly, physical traders—on the sidelines until this new potential bloodbath has run its course.

This isn't to say that some physical trading isn't going on. Recent major purchases by Egypt and Tunisia show that there's still appetite for at least white sugar despite market volatility. Perhaps they too see the bounce getting ready to start. India is saying it has plenty and won't buy for a while, but they're usually wrong in their timings and will get stuck only buying expensive sugar.

Yet while Indian sugar traders are slow in their market decision-making, their banks run the risk of being far too quick. Already there are signs that banks may withdraw credit in fear that they based funding on cane prices at the top end rather than the low end of the market. But as has been seen in Brazil, and indeed in India as well as elsewhere, if the credit dries up then so does payments to farmers and thus desire to plant more cane. What does get planted ends up not getting fertilised properly, meaning lower yields and disappointing harvests. Mexico is feeling the no-credit, no-fertiliser, no-yield pinch right now just when prices have been at their craziest and so aren't able to take advantage as they'd like.

But for India, this means the potential for future failed crops is lining up before the current one has even passed and the country's moves into the upswing of its up-and-down production cycle. Without ready access to credit, farmers won't get paid and they've already shown how happy they are to switch to paddy crops. If 30-cent sugar is something that global consumers want to avoid in the near future, then there must be credit.

The drying up of credit post-economic crisis hit the major planned expansion in Brazil in a big way. What looked like a crazy, never-before-seen kind of boom in new mill construction and greenfield sugarcane expansion came to a halt as banks got nervous and closed their doors. This type of credit crunch does lead to an industry cleanse that takes the weaker players out but forced industry consolidation rarely leaves the remaining players stronger—just in more debt as a result of taking on the heavy burden of failing mills with potential for future gains and little access to the credit required to make a success out of them. Industry consolidation must be more natural and less hurky jerky in order to be sustainable, or the risk is high that the entire house of cards comes tumbling down.

So even if technical indicators show that futures may be preparing for a 'substantial' or a 'sizeable' bounce, it may be long-forgotten if the rest of the industry—and that means banks, farmers and investors—don't start making more medium-term decisions and leave the seemingly irrational, short-sighted and short-term decisions behind.