

Coffee volatility to linger

Coffee has had an explosive year due to the impact of drought and frost on the Brazilian crop. Supply chain bottlenecks have also helped push the market higher. There is plenty of uncertainty for the 2022 outlook; much will depend on rainfall over the Brazilian rainy season



Drought has hit coffee production across Brazil as this farmer in Sao Paulo knows all too well

Brazilian woes

The old song may claim 'there's an awful lot of coffee in Brazil', but there's not so much this year. Adverse weather across the country has had an impact on several crops including corn and sugar. However, the impact on Arabica coffee has been significant, and that's pushed prices to the highest levels since 2011.

Brazil has battled not only with frost this year, but also drought. There are concerns that large areas of coffee trees were damaged which will have an impact on production next season. Similarly, drought is also expected to weigh on the forthcoming harvest, although how much will depend on precipitation levels over the rainy season.

The Brazilian 2021/22 coffee crop is complete and the latest estimate from the country's agricultural agency, Conab, is that production over the season totalled 46.88m bags (60kg bags), down 25.7% year-on-year. Dry weather weighed on the crop, while it was also the lower-yielding year of the biennial cycle.

There is plenty of uncertainty over the impact of both drought and frost

For the 2022/23 season, while it will be the higher-yielding season, there is plenty of uncertainty over the impact of both drought and frost. There are estimates suggesting that as much as 12m bags of coffee could be lost in Brazil next season due to the conditions. However, in more recent months, growing regions have seen higher than usual rainfall. This was particularly the case in October. However, Brazil will need to see continued good rainfall in the coming months to ease concerns. The issue is that US forecasters see a 90% chance of La Niña conditions over the Northern Hemisphere winter and 50% through into spring. Generally, dry weather in Brazil is associated with a La Niña event. A lot of the strength we have seen in the market more recently reflects these weather concerns.

Multi-year high coffee prices along with the weakness in the Brazilian real means that farmers in the country are seeing the highest prices in local currency terms on record. However, many of them would have sold forward and so are unable to take full advantage of the higher spot prices. There have been reports of some farmers defaulting or wanting to renegotiate given the higher prices. The high price environment also means that we could see increased plantings for coffee. However, given that these take several years to develop, any increase there will not be felt for a few years.

Logistics should improve

Like many other markets, coffee has been affected by supply chain issues. Covid-19 restrictions have contributed to supply issues, while a lack of containers has pushed freight rates higher. This has seen exchange inventories dropping from around 2.2m bags in the middle of this year to around 1.6m bags currently, further supporting prices.

However, as we go into 2022, we expect supply chain issues to gradually improve which should put less upward pressure on the coffee market. The key risk remains further strict restrictions in key growing regions should see another hard wave of the coronavirus.

2021/22 global coffee deficit

The International Coffee Organisation estimates that the global coffee market saw a surplus of 1.97m bags in the 2020/21 season (October 2020- September 2021).

Consumption is estimated to have grown by 1.9% YoY to 167.7m bags and this is after having fallen by 1.8% in the previous season. The fall in consumption last season was due to Covid-19 related lockdowns and the growth we have seen this year takes consumption back to pre-Covid-19 levels. While we still wait for what Omicron will throw at us, if most economies continue easing emergency restrictions, then demand is likely to continue growing in 2021/22. Despite the smaller Brazilian harvest this season, global production during the 2020/21 coffee year still edged higher by 0.4% YoY to 169.6m bags.

For the 2021/22 coffee year, demand is expected to outstrip supply. This will be driven by a combination of further growth in demand, along with a Brazilian crop weighed down by frost and

possibly drought. However, much will depend on precipitation in the coming months. There are some who are forecasting a deficit of as much as 7m bags. The expectation of a deficit in 2021/22 and the uncertainty on how big this deficit could be suggest that prices should remain well supported.

ING forecasts

	1Q22	2Q22	3Q22	4Q22	FY22
ICE Arabica Coffee (US\$/lb)	215	195	185	175	195

Source: ING Research

Author

Warren Patterson

Head of Commodities Strategy

Warren.Patterson@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user’s investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.