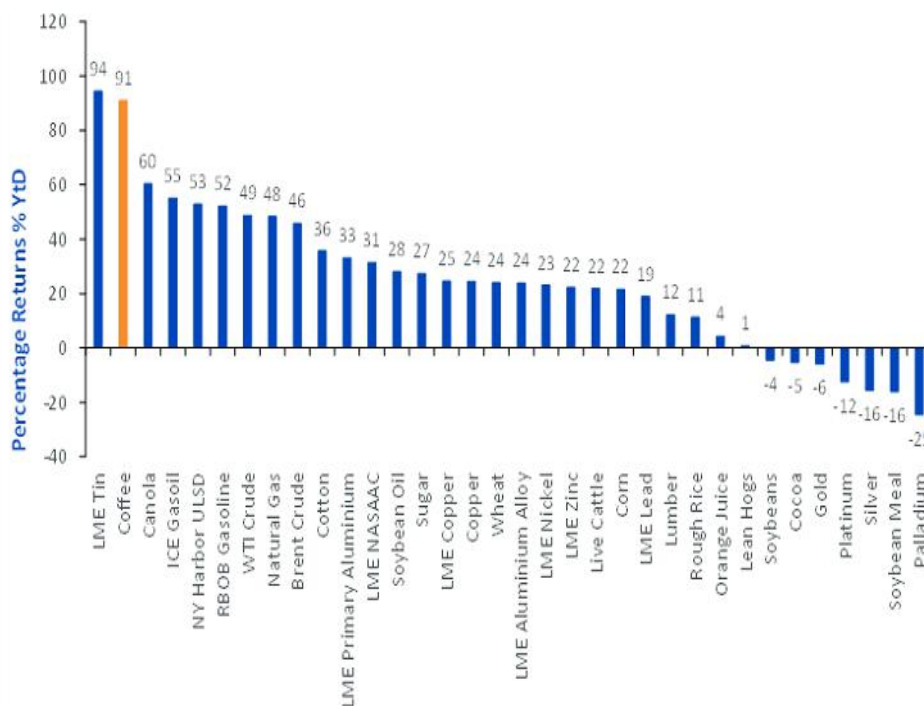


WHAT'S HOT – COFFEE CAUSING A STIR IN COMMODITY MARKETS

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Coffee prices are trading at their highest level in 10 years and is the second-best performing commodity Year to date (Ytd)¹. A combination of a production shortfall in Brazil (the world's largest coffee producer) due to extreme weather conditions coupled with supply disruptions should continue to propel coffee prices higher in 2022.

Figure 1 – Commodity Futures Ranked Percentage Returns Year to Date



Source: Bloomberg, WisdomTree as of 8 December 2021

Historical performance is not an indication of future performance and any investments may go down in value.

Lower inventory levels to keep prices vulnerable to supply shocks

The coffee harvest has a biennial cycle. This implies that a crop year with a good harvest (the “on year”) will be followed by a crop year with a lower harvest (the “off-

year”). The last crop in Brazil was disappointing not only because it was an off-year, but Brazil also faced unfavourable weather conditions resulting in weaker supply. This was evident from Companhia Nacional de Abastecimento’s (“CONAB”) latest estimate for Brazil’s 2021/22 coffee crop, which is down 25.7% over the prior year³. As a consequence of lower output, global ending inventories are expected to decline from 7.9mn bags to 3.2mn. The weaker forecast represents the lower availability of coffee for exports, following weather setbacks to the 2021 harvest and logistical bottlenecks. Further obstacles have emerged towards the latter half of 2021 in the form of elevated shipping costs and high fertilizer prices, which are also likely to lend a tailwind to coffee prices. According to the United States Department of Agriculture (USDA), Brazil’s coffee exports are expected to slump by 12.45mn bags over the prior year to 33.22mn bags in 2021/22⁴. A decline of that level would represent the largest decline in volume terms by a distance and the sharpest fall in percentage terms at 27% since 1985/86. USDA has been citing more cases of “defaults”, where coffee farmers failed to deliver pre-agreed contracts on the physical market because of excessive hoarding of coffee beans amidst the steep rise in prices. USDA also expects global consumption to rise by 1.8 million bags to 165.0 million, with the largest gains in the European Union, the United States, and Brazil.

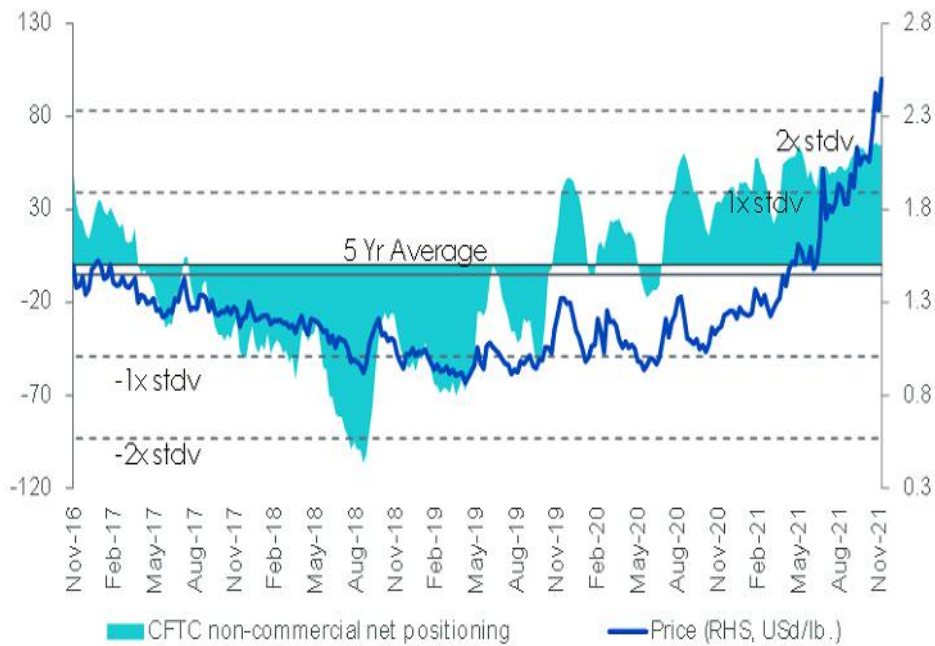
Outlook for 2022/23 clouded in uncertainty

While the Brazilian 2022/23 coffee crop will be an on year (of the biennial cycle), there is still plenty of uncertainty shrouding the outlook of the coffee crop. According to Fitch, the La Nina⁵ weather phenomenon could cause further problems for the upcoming crop. The arrival of the La Nina weather phenomenon, which tends to bring dryness in the southern part of South America for the second consecutive year, has also dampened the outlook for the coffee crop in the upcoming season.

Conclusion

The supply tightness on the physical market has also pushed the front end of the coffee futures curve into backwardation from contango, thereby yielding a positive roll yield of 0.2% versus -1.4% a month back. Coffee stocks in the International Continental Exchange’s (ICE) warehouses have declined further and currently find themselves at a 9-month low of 1.78mn bags. Net speculative positioning in coffee remains 1-standard deviation above the 5-year average underscoring the bullish sentiment towards coffee. While the recent rise of the Omicron variant could threaten demand as countries decide to restrain mobility, we believe the fast-spreading variant could also complicate supply-chain disruptions and potentially drive Arabica prices higher.

Figure 2 – Net Speculative Positioning in Coffee Futures over the past 5 years



Source: Commodity Futures Trading Commission, WisdomTree as of 7 December 2021

Historical performance is not an indication of future performance and any investments may go down in value.

Sources

- 1 Bloomberg, tracking commodity futures price from 31 December 2020 to 8 December 2021
- 2 Bloomberg Ticker - KCA Comdty, price performance from 31 December 2020 to 8 December 2021
- 3 Companhia Nacional de Abastecimento (Conab) - Brazil leading coffee forecasting agency
- 4 United States Department of Agriculture - Coffee: world Markets and Trade Report
- 5 La Niña is a complex weather pattern that occurs every few years, as a result of variations in ocean temperatures in the equatorial band of the Pacific

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