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Cocoamarket Report

ANNUAL REVIEW 2002

By taking a retrospective view on the cocoa market at the end of the year the conclusion is simple: 2002 was a very special year. We noticed a very strong rally backed by speculative buying in anticipation of a large deficit, a substantial decline of the grindings, a successful squeeze, an enormous decline in October/November and last but not least, the continuous civil war in the major producing country Ivory Coast. The price range has been between GBP 950 and GBP 1650 on basis of the second position and on balance prices are GBP 300 higher.

The strength, set in at the end of 2001, continued early January, but was briefly interrupted after the publication of the strongly reduced 4th quarter 2001 grinding figures of Holland, Germany and Brazil. These lower grinding figures were a proof of the assumption that global grindings were declining strongly due to a reduced use of capacity in the converters section. Already for some time the converting industry was an unprofitable operation due to enormous pressure on the butter ratio. For a great part this was a reflection of the huge stocks of butter built up in previous years, high cocoa bean differentials and a backwardation in the forward structure. This position forced world's leading converter to close down some factories, while many small converters all over the world were reducing or stopping grinding operations as well. Another depressing price factor was the favourable arrival figure in the Ivory Coast, which was partly due to smuggling of large quantities of Ghana beans into Ivory Coast, where higher prices were paid. All this bearish information, however, was neglected by the market and prices rallied again at the end of the month.

In February the rally continued, despite high arrivals in Ivory Coast. The fear for a squeeze on the July and/or September position on the London terminal market attracted a wave of buying and the premium of September 2002 against March 2003 widened to GBP 125. Fundamentally there was a lot of uncertainty in the market with very divergent views on the deficit figure for the 2001/2 crop, varying between 250.000 and 50.000 tonnes. Differentials were just coming off slightly in spite of the better than expected arrival figures in Ivory Coast and the declining grinding figures, but remained at a high premium. This was mainly due to the buying strategy of most important users - buying main crop cocoa during the harvest season - but it was also due to the withdrawal of large quantities by the companies, who were orchestrating the squeeze on the July.

During the beginning of March the bullish performance continued, particularly under influence of the technical tension on the July and September. As an example, the premium of July 2002 over March 2003 widened to about GBP 180, the highest premium in decades. In conjunction with the falling industry demand for main crop cocoa the differential premiums eroded quickly. As a result of large switch operations the open positions on the July and September increased strongly. Also the combined net speculative position on the New York market grew to a long of 12.000 lots with, quite unique in recent years, both the small and large specs operating from the same side.

Under nervous conditions prices remained in a relatively narrow range of about GBP 100 during April, May and a great part of June. The strongly reduced use of cocoa beans was confirmed by the publication of substantial declined 1st quarter grindings of all-important consuming countries. The net speculative position in New York declined to almost zero, since the interest of funds in the cocoa market was faded away almost completely. The erosion of nearby differentials continued as well; West African cocoa was finally traded at strong discounts against premiums of GBP 70 in January/February, while also large quantities of Sulawesi cocoa were rerouted to Europe. The market was completely under the influence of the squeeze, while in the meantime most analysts reduced their deficit for the 2001/2002 crop strongly. The spread structure for both 2002 and 2003 positions was liable to strong fluctuations. Indeed, a very difficult situation for most participants.

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At the end of June prices broke out of the 3 months range and funds showed again more interest in the market, resulting in rapid changes in the net speculative position. Gradings were in extremely large numbers and more than 200.000 tonnes were tenderable, of which only 2 lots of 1000 tonnes bulk, but it was a problem that no one knew which part of the tenderable cocoa was already in the hands of the long players. As a result of the squeeze the arbitration premium of London over New York widened to enormous proportions. The critical situation was well reflected by the big swings in the premium of July over September. Finally July expired with the massive tendering of 204.380 tonnes and at a premium of GBP 45 over September. The London company, who took up the majority of this vast tonnage, attracted much attention in the media, but for the insiders it was evident, that the success of the squeeze was much more a result of the practical impossibility of changing stocks of bulk cocoa into tenderable units than to the level of stocks. This logistic problem was neglected 3 years ago by creating the new contract allowing bulk deliveries.

Since the open position of September still was very substantial with over 50.000 lots, another squeeze was generally feared. The premium of over GBP 100 held for some weeks, while also the December position was traded at a premium of GBP 50 over March. Already at the end of July a liquidation on the September position started in New York, but it lasted upto early August before the London market was faced with a similar move. Most likely due to intervention very aggressive liquidation of the September position entered the market and just in a couple of days the premium evaporated totally. This was not the only sensational effect, since at the same time that nearby prices collapsed forward prices increased strongly. Indeed a spectacular price development we cannot remember to have seen earlier in the cocoa market. To make it more complex the open position of September in London only diminished strongly far later, while the large speculative short position in New York rose substantially.

After a phase of consolidation the market was faced with the civil war in Ivory Coast, the feature of the last few months. On 19th September a rebellion started in the north of Ivory Coast. Without hardly any resistance from the army a small, but well armed and organized group of Muslim rebels took over power of Bouake, the second city of Ivory Coast, and surroundings. Although the cocoa zones were still under the control of the government the rebellion attracted very strong buying, since everyone had to cover against a possible disturbance in the evacution of the forthcoming new crop and all involved negative aspects. At the beginning of October the rebels went westward and in a couple of days they got control over Daloa, the center of an important cocoa area. As a matter of fact this attracted very strong buying and prices rallied to about GBP 1650, the highest level in 16 years.

Already after 4 days Daloa fell back in the hands of the government and in a couple of days prices declined GBP 300, even more than the “war premium”. The selling was also encouraged by the signing of a cease-fire agreement, which afterwards has proved to be meaningless. The selling was interrupted for a short period, during which prices recovered GBP 140 on reports of lower arrival figures and continuation of unrest. Another wave of selling started at the end of October and lasted till the end of November, resulting in a decline of another GBP 300. Despite many logistical problems the arrival figures in the ports of San Pedro and Abidjan were slightly higher than last season and certainly far higher than expected under those circumstances.

Despite the presence of the French army and the help of mercenaries, the rebels - meanwhile other groups have joined the MPCI - were gaining ground in the northern part of the western cocoa zones. The uncertainty arising from the civil war attracted fresh buying, as a result of which prices rallied strongly to GBP 1400. While everyday reports about clashes between the rebels and the government army supported by the French army were published, prices eroded during the rest of the month gradually under the pressure of ongoing hedging, ending the year at GBP 1300.

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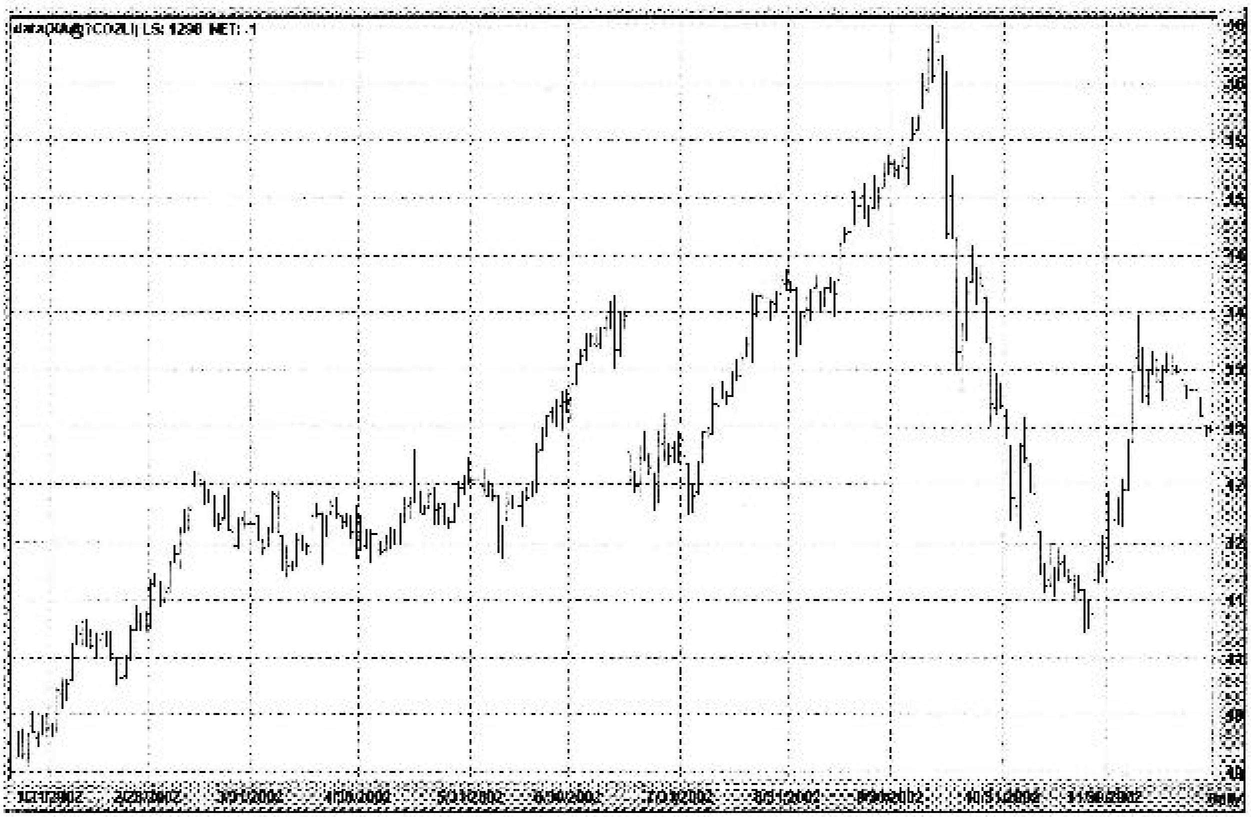
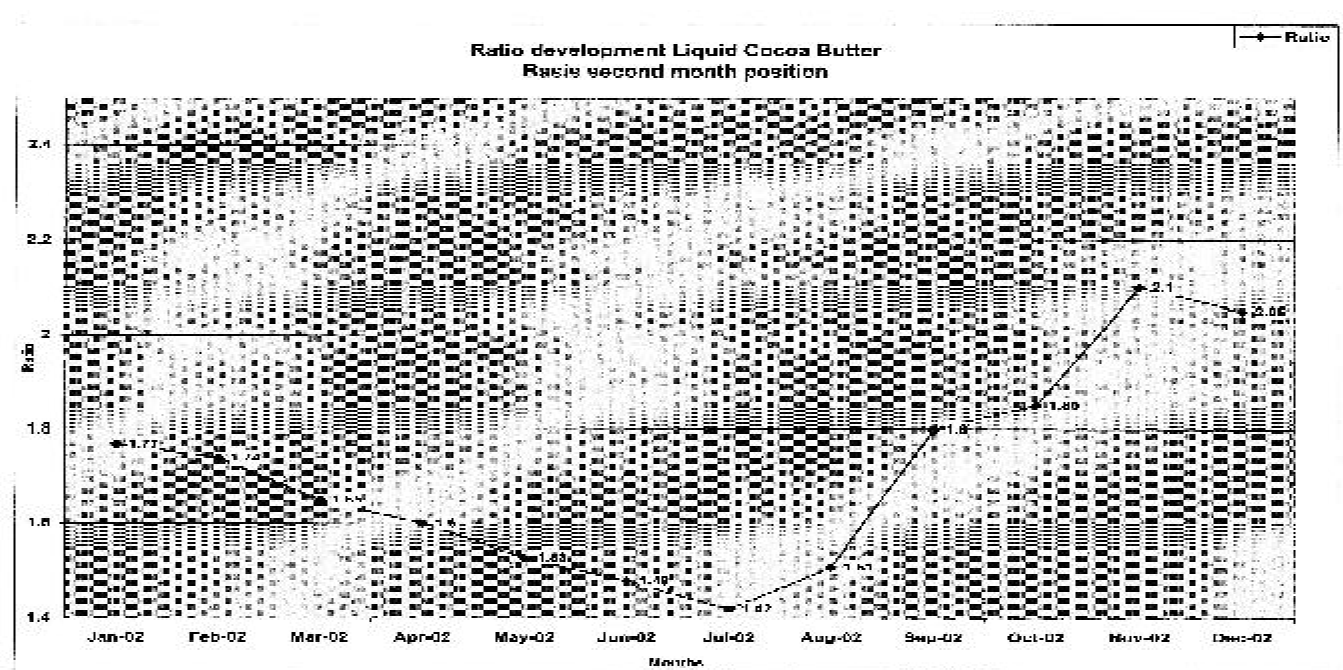
The effects of the war as well as the manipulation of the terminal markets towards the industry are numerous. First of all it shows how dangerous it can be to be dependent on the production of one country; this certainly will lead to bigger investments in other continents such as Asia and South America. Secondly, large multinationals both in the converter and chocolate industry will be forced to adapt their purchasing strategy and to hold larger stocks. To which extent the war will affect production in Ivory Coast is fully uncertain. The next few weeks all attention will be focused on the arrivals, but in general it is expected that on the longer term production will diminish slightly. Most analysts forecast now a small deficit for the 2002/3 crop, but on the longer term it is hard to predict to which extent consumption will be affected by the higher prices. Certainly, prices will remain volatile and as soon as the abundant supply of main crop cocoa will finish - around January/February - the market will be much more vulnerable to all eventual negative aspects.

Also the cocoa products market has been very volatile this year with huge price fluctuations both in cocoa butter and solids. Under the influence of various factors such as substantial stocks of butter in Europe and the USA, an inverted market structure, a slow demand for butter, a strong demand for solids, cocoa butter ratios gradually declined from 1.90 at the beginning of 2002 to a low of 1.42 at the end of July. This strong decline occurred in a market, in which many factories were stopping or reducing use of capacity, forced by unprofitable operations despite a strong price rise of the solids. As a consequence the stocks of butter reduced strongly, mainly in Europe, and from the beginning of August a strong recovery was set in. Industries, who only modestly extended cover during the first half year, did aggressively return as a buyer, partly supported by the improved structure and this led to an impressive and rapid recovery of the butter ratio to well over 2.20 during October/November. In December ratios eased slightly again and are now just below 2.00 for first quarter 2003 deliveries.

We wish all our readers a prosperous 2003.

On page 4 you wil find the Continuation 2nd position London.




Ratio development Liquid Cocoa Butter
Basis second month position
Ratio
2.4
2.2
2
1.8
1.6
1.4
1.77
1.8
2.1
2.05
1.6
1.63
1.42
Jan-02
Feb-02
Mar-02
Apr-02
May-02
Jun-02
Jul-02
Aug-02
Sep-02
Oct-02
Nov-02
Dec-02