



Sugar. Continuing to sour.

- The international sugar market has continued to sour over the past few months.
- Fundamentally the market has changed drastically. This added to the increasingly cautious market sentiment.
- An additional 3 ½ million tonnes of sugar was 'found' in India this season. This represented 25pct of original forecasts.
- After a spike, prices only stop falling once they erase all the original gains. This suggests more downside to come.
- We have swung the axe through our 2010/11 price forecasts.

A fundamentally different market now...

The one thing we have learnt from this turbulent sugar market is we can never say never! Whilst we were taking some time off to recharge the batteries in April, the sugar market was moving at full steam. Downwards. Raw sugar futures (nearby contract) at the end of April were below USc15/lb, less than half of where they were only a few months earlier. At the time of writing they had fallen further to USc14.41/lb.

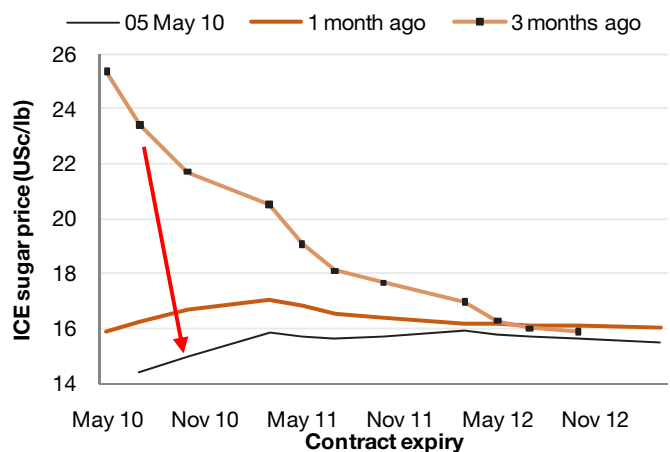
Our judgment in early March that the market may bounce proved incorrect. But the market is now a fundamentally different beast. The supply and demand situation for the key nations did an about-face while we were away.

Figure 1: ICE raw sugar prices (first contract, USc/lb)



Source: Bloomberg, CBA

Figure 2: ICE raw sugar futures curve (USc/lb)



Source: Bloomberg, CBA

What's different?

1. The size of India's crop

We were once warned not to believe anything we heard from India. Perhaps we should have paid more attention. Back at the start of 2010, Indian sugar production for the current season was forecast well below 15mt against consumption requirements of 22-23mt. This was to follow the previous season's 14.7mt crop, which would have created a deficit of around 8mt. This deficit was to be met by imports and existing stocks. Because stocks were tight, India's reliance on imports was expected to be immense. This anticipated buying was the primary catalyst for prices shooting up toward 30cents.



However, in March and April a series of upward revisions were made to India's production prospects. Miraculously, Indian production for the current crushing season (nearly complete) is now estimated at 18.5mt. We remain perplexed at how the Indians can discover an additional 3.5mt in such a short period of time. But they did, and the world is now different. 3.5mt of potential imports are no longer needed.

2. Brazil's immediate production and export response

Brazil continued to crush cane throughout their traditional 'off-season'. Aided by favourable weather conditions and a desire by the Brazilians to take advantage of the firm prices (while they lasted!) The Brazilian sector focused on supplying the export market, and according to some analysts an additional 1mt of raw sugar was available for the world market. The combined impact of Brazil and India is a 4-5mt swing in prompt net import requirements.

Unica's final numbers for the 2009/10 season (finished 31 Mar) show total cane crushed was 542mt, up 7.3pct on the previous year. This included a huge 23mt of cane crushed during the traditional inter-harvest period of Jan-Mar. Sugar yields (TRS) for the full season were disappointing, down 7.5pct (yoy). But a swing to sugar production (away from ethanol) resulted in total sugar production up by 7pct to 28.6mt.

3. Focus on 2010/11 and beyond

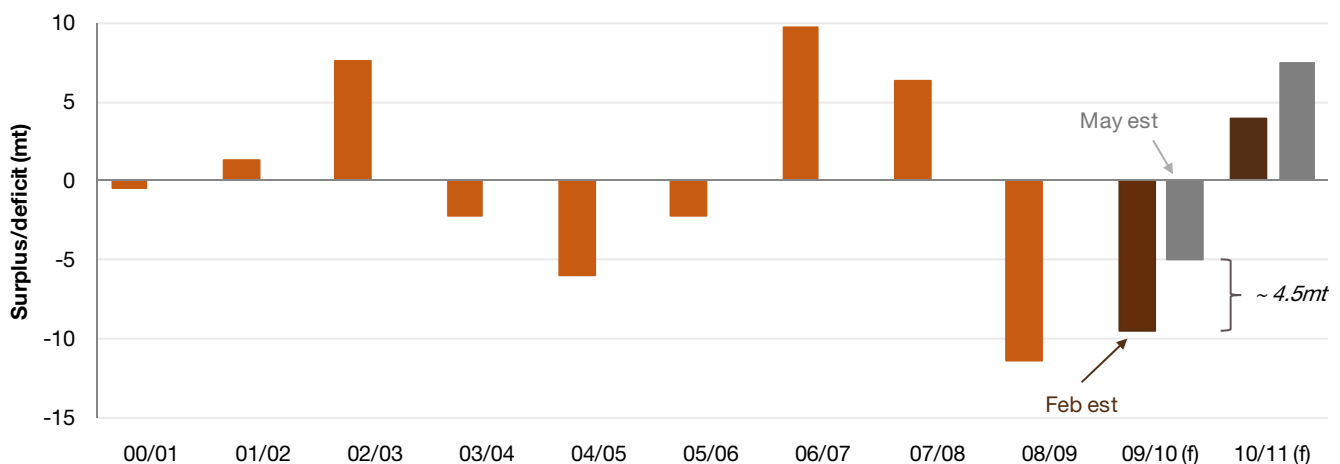
In the past 6 weeks the market has paid increasing attention to planned production increases for 2010/11 and beyond. Increased production in response to the rampantly high prices observed late last year and at the start of this year. This will be a global production response, but again India and Brazil will play a central role.

In India, talk is that the 2010/11 crop will cover domestic consumption requirements. Bloomberg reported (4th May) the Indian Farm Minister as saying production 'may exceed' annual demand of ~23mt. The Minister was also quoted as saying "forget about imports, we will be in a position to export next year". Media reports indicate that production may be as large as 24-25mt. Reports that India will consider the immediate reintroduction of the 60pct sugar import tax signifies that India need to import has greatly diminished.

In Brazil, centre-south cane production for 2010/11 is forecast to be at least 600mt, up 11pct from last year and nearly 20pct from 2008/09. Sugar production may reach 34mt, nearly 20pct higher than last year.

Incorporating the latest numbers for India and Brazil into our global sugar model reveals the extent to which the global situation has changed. Rather than a 2009/10 deficit of near 9mt, it now seems likely the deficit will be trimmed to around 5mt. This has implications for the size of the 2010/11 surplus which now looks likely to come in between 6-8mt. The result is import requirements are lower and ending stocks will be higher. Two factors that weigh on prices.

Figure 4: The global sugar balance has changed.



Source: CBA estimate.



When will prices stop falling?

History suggests that after a spike, sugar prices only stop falling once most (if not all) the hard earned gains have been erased. In other words the market needs to get back to where it started.

Panel 1 (to the right) plots the weekly movements of NY raw sugar futures during the 3 major spikes over the past 5 decades. These are the 1974, 1980 and 2005 spikes. We also present the trajectory of the most recent 2009/10 spike.

Two key features are evident:

- Prices return to where they started; and
- Each cycle is somewhat symmetrical.

This suggests (rather crudely) that the raw sugar market will not stop trending lower until they get near their late 2008 levels of less than 11 cents per pound.

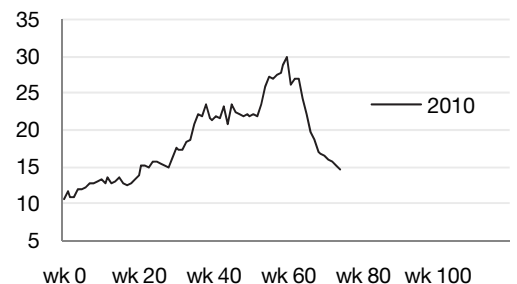
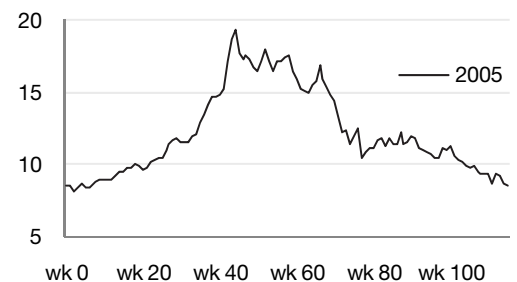
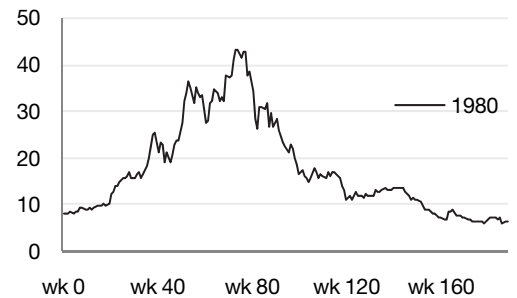
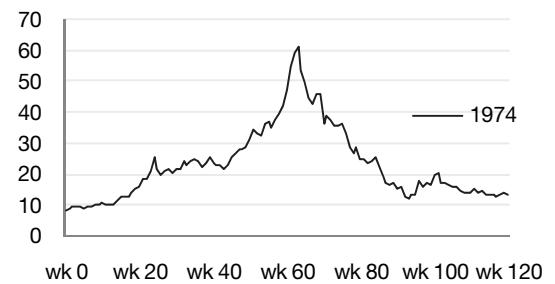
Furthermore if prior rules of symmetry are repeated, this would occur by March 2011.¹ However the recent trajectory of the decline suggests this could come sooner rather than later.

Can we realistically see this scenario becoming reality in the current market?

Definitely. Market sentiment and technical trading alone can take the market there quickly. Developments in the fundamental space also suggest this could become reality. In Q1 next year India will have nearly completed the 2010/11 cane crush. Early estimates suggest this could be large enough to produce an exportable surplus. And Brazil will be about to ramp up their 2011 centre-south cane harvest. This is likely to be another record breaking crush by the ever expanding Brazilian sector.

It seems likely that a production concern in either India or Brazil over the coming 12 months will be required to reverse the decline in price. This is possible, but shouldn't be banked on.

Panel 1: Previous Sugar Price Spikes - NY Raw Sugar Futures (1st contract, USc/lb)



Source: CBA Research.

Revision to our price forecasts

The changing fundamentals in the sugar market and continued collapse in prices warrant a change to our near term price expectations. Indeed we have taken an axe to our existing numbers, and we have front loaded our existing declines into a few short months. But thanks to movements over the past 2 months, a large proportion of these declines are now assumed to be behind us.

¹ Based on the fact the rally commenced in the Dec 08 peaked in late Jan 09, a total of 60 weeks.



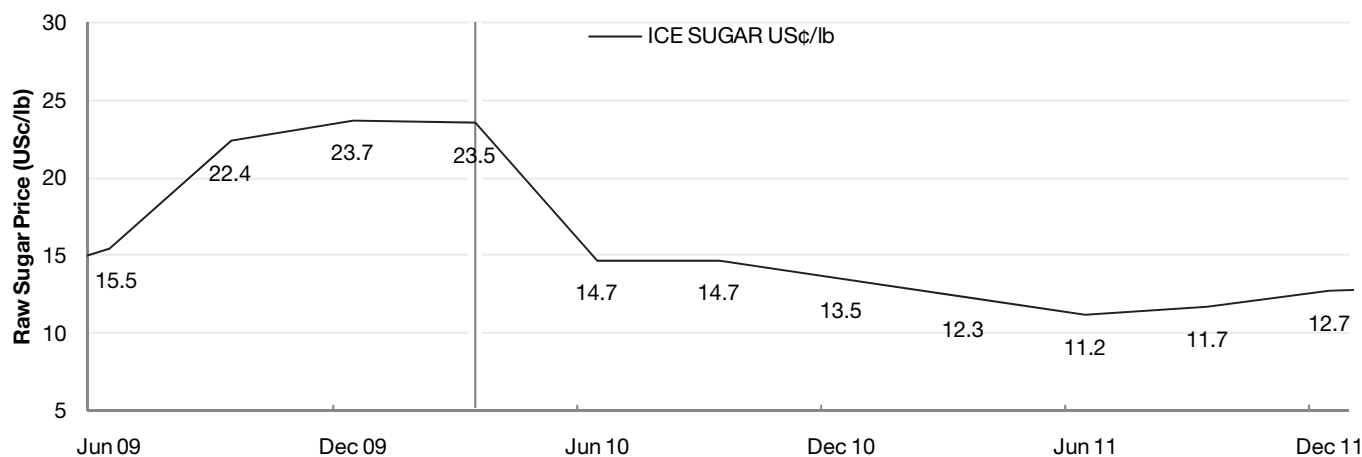
Indeed, we don't expect the extraordinary rate of decline to be repeated for the remainder of the year. Our primary thesis is that the market is still historically tight, and therefore vulnerable to any negative production scares. Upside and downside risks are clearly evident in the current environment.

We feel that the market is likely see the year out in a broad band from US13-16c/lb. Further declines are now expected in the first half of 2011 as the second instalment of the global production response commences. Our expectations of a strong Australian dollar this year will add additional weight to local prices (see Figure 6).

We remain optimistic about longer term sugar prices. Our view is primarily based incomes in Asia, our assumption of growing medium term Chinese import requirements, and increasing competition for cane by the renewable fuel sector.

But don't expect a smooth ride. The historic boom-bust cycles seem set to continue...

Figure 5: ICE raw sugar price forecast (nearby contract, USc/lb, quarterly average)



Source: CBA Research

Figure 6: Forecasts

		Current at 5/05/10	Actual (Quarter Average)				Forecast (Quarter Average)							
			Jun 09	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10	Mar 11	Jun 11	Sep 11	Dec 11	Mar 12
Raw Sugar (ICE)	USc/lb	14.4	15.5	22.4	23.7	23.5	14.7	14.7	13.5	12.3	11.2	11.7	12.7	13.0
	US\$/t	318	341	493	523	519	324	323	298	272	246	257	279	287
	A\$/t	350	438	578	580	578	346	348	328	307	282	300	329	337
Currencies (period end)														
AUD/USD		0.91	0.81	0.88	0.90	0.92	0.95	0.92	0.90	0.88	0.87	0.85	0.85	0.85



Research

Commodities		Telephone	Email Address
David Moore	Base & Precious Metals, Oil	+612 9118 1099	MoorDa@cba.com.au
Luke Mathews	Agri Commodities	+612 9118 1098	luke.mathews@cba.com.au
Lachlan Shaw	Iron Ore, Coal, Steel, LNG	+613 9675 8618	lachlan.shaw@cba.com.au

Economics		Telephone	Email Address
Michael Blythe	Chief Economist	+612 9118 1101	michael.blythe@cba.com.au
Michael Workman	Senior Economist	+612 9118 1019	michael.workman@cba.com.au
John Peters	Senior Economist	+612 9117 0112	john.peters@cba.com.au
James McIntyre	Economist	+612 9118 1100	james.mcintyre@cba.com.au
George Johns	International Economist	+44 207 710 3918	george.johns@cba.com.au

Fixed Income		Telephone	Email Address
Adam Donaldson	Head of Debt Research	+612 9118 1095	adam.donaldson@cba.com.au
Philip Brown	Fixed Income Quantitative Strategist	+612 9118 1090	philip.brown@cba.com.au
Michael Bors	Credit Research Analyst	+612 9118 1108	borsma@cba.com.au
Steve Shoober	Credit Research Analyst	+612 9118 1096	steve.shoober@cba.com.au
Winnie Chee	Securitized Product	+612 9118 1104	winnie.chee@cba.com.au
Tally Dewan	Quantitative Analyst	+612 9118 1105	tally.dewan@cba.com.au
Kevin Ward	Database Manager	+612 9118 1960	kevin.ward@cba.com.au

Foreign Exchange		Telephone	Email Address
Richard Grace	Chief Currency Strategist	+612 9117 0080	richard.grace@cba.com.au
Joseph Capurso	Currency Strategist	+612 9118 1106	joseph.capurso@cba.com.au
Sara Hoenig	Economist	+612 9118 1107	sara.hoenig@cba.com.au

Delivery Channels & Publications		Telephone	Email Address
Monica Eley	Internet/Intranet	+612 9118 1097	monica.eley@cba.com.au
Ai-Quynh Mac	Information Services	+612 9118 1102	maca@cba.com.au

New Zealand		Telephone	Email Address
Chris Tennent-Brown	CBA NZ Economist	+64 9374 8819	chris.tennent-brown@asbbank.co.nz
Nick Tuffley	ASB Chief Economist	+64 9374 8604	nick.tuffley@asb.co.nz
Jane Turner	Economist	+64 9374 8185	jane.turner@asb.co.nz
Christina Leung	Economist	+64 9369 4421	christina.leung@asb.co.nz

Sales

Institutional	Telephone	Equities	Telephone
Syd FX	+612 9117 0190	Syd	+612 9118 1446
	+612 9117 0341	Asia	+613 9675 6967
Credit	+612 9117 0020	Lon/Eu	+44 20 7710 3573
Japan Desk	+612 9117 0025	NY	+1212 336 7749
Melb	+613 9675 6815		
	+613 9675 7495	Corporate	Telephone
	+613 9675 6618	NSW	+612 9117 0377
	+613 9675 7757	VIC	+612 9675 7737
Lon FX	+44 20 7329 6266	SA	+618 8206 4155
Debt & Derivatives	+44 20 7329 6444	WA	+618 9482 6044
Corporate	+44 20 7710 3905	QLD	+617 3015 4525
HK	+852 2844 7538	NZ	+64 9375 5738
Sing	+65 6349 7077	Metals Desk	+612 9117 0069
NY	+1212 336 7739	Agri Desk (Corp)	+612 9117 0157
		Agri Desk	+612 9117 0145



Please view our website at www.research.commbank.com.au. The Commonwealth Bank of Australia ABN 48 123 123 124 AFSL 234945 ("the Bank") and its subsidiaries, including Commonwealth Securities Limited ABN 60 067 254 399 AFSL 238814 ("CommSec"), Commonwealth Australia Securities LLC, CBA Europe Ltd and Global Markets Research, are domestic or foreign entities or business areas of the Commonwealth Bank Group of Companies (CBGOC). CBGOC and their directors, employees and representatives are referred to in this Appendix as "the Group". This report is published solely for informational purposes and is not to be construed as a solicitation or an offer to buy any securities or financial instruments. This report has been prepared without taking account of the objectives, financial situation and capacity to bear loss, knowledge, experience or needs of any specific person who may receive this report. No member of the Group does, or is required to, assess the appropriateness or suitability of the report for recipients who therefore do not benefit from any regulatory protections in this regard. All recipients should, before acting on the information in this report, consider the appropriateness and suitability of the information, having regard to their own objectives, financial situation and needs, and, if necessary seek the appropriate professional, foreign exchange or financial advice regarding the content of this report. We believe that the information in this report is correct and any opinions, conclusions or recommendations are reasonably held or made, based on the information available at the time of its compilation, but no representation or warranty, either expressed or implied, is made or provided as to accuracy, reliability or completeness of any statement made in this report. Any opinions, conclusions or recommendations set forth in this report are subject to change without notice and may differ or be contrary to the opinions, conclusions or recommendations expressed elsewhere by the Group. We are under no obligation to, and do not, update or keep current the information contained in this report. The Group does not accept any liability for any loss or damage arising out of the use of all or any part of this report. Any valuations, projections and forecasts contained in this report are based on a number of assumptions and estimates and are subject to contingencies and uncertainties. Different assumptions and estimates could result in materially different results. The Group does not represent or warrant that any of these valuations, projections or forecasts, or any of the underlying assumptions or estimates, will be met. Past performance is not a reliable indicator of future performance. The Group has provided, provides, or seeks to provide, investment banking, capital markets and/or other services, including financial services, to the companies described in the report and their associates. This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would subject any entity within the Group to any registration or licensing requirement within such jurisdiction. All material presented in this report, unless specifically indicated otherwise, is under copyright to the Group. None of the material, nor its content, nor any copy of it, may be altered in any way, transmitted to, copied or distributed to any other party, without the prior written permission of the appropriate entity within the Group. In the case of certain products, the Bank or one of its related bodies corporate is or may be the only market maker. The Group, its agents, associates and clients have or have had long or short positions in the securities or other financial instruments referred to herein, and may at any time make purchases and/or sales in such interests or securities as principal or agent, including selling to or buying from clients on a principal basis and may engage in transactions in a manner inconsistent with this report.

US Investors: If you would like to speak to someone regarding the subject securities described in this report, please contact Commonwealth Australia Securities LLC (the "US Broker-Dealer"), a broker-dealer registered under the U.S. Securities Exchange Act of 1934 (the "Exchange Act") and a member of the Financial Industry Regulatory Authority ("FINRA") at 1 (212) 336-7737. This report was prepared, approved and published by Global Markets Research, a division of Commonwealth Bank of Australia ABN 48 123 123 124 AFSL 234945 ("the Bank") and distributed in the U.S. by the US Broker-Dealer. The Bank is not registered as a broker-dealer under the Exchange Act and is not a member of FINRA or any U.S. self-regulatory organization. Commonwealth Australia Securities LLC ("US Broker-Dealer") is a wholly owned, but non-guaranteed, subsidiary of the Bank, organized under the laws of the State of Delaware, USA, with limited liability. The US Broker-Dealer is not authorized to engage in the underwriting of securities and does not make markets or otherwise engage in any trading in the securities of the subject companies described in our research reports. The US Broker-Dealer is the distributor of this research report in the United States under Rule 15a-6 of the Exchange Act and accepts responsibility for its content. Global Markets Research and the US Broker-Dealer are affiliates under common control. Computation of 1% beneficial ownership is based upon the methodology used to compute ownership under Section 13(d) of the Exchange Act. The securities discussed in this research report may not be eligible for sale in all States or countries, and such securities may not be suitable for all types of investors. Offers and sales of securities discussed in this research report, and the distribution of this report, may be made only in States and countries where such securities are exempt from registration or qualification or have been so registered or qualified for offer and sale, and in accordance with applicable broker-dealer and agent/salesman registration or licensing requirements. The preparer of this research report is employed by Global Markets Research and is not registered or qualified as a research analyst, representative, or associated person under the rules of FINRA, the New York Stock Exchange, Inc., any other U.S. self-regulatory organization, or the laws, rules or regulations of any State.

European Investors: This report is published, approved and distributed in the UK by the Bank and by CBA Europe Ltd ("CBAE"). The Bank and CBAE are both registered in England (No. BR250 and 05687023 respectively) and authorised and regulated in the UK by the Financial Services Authority ("FSA"). This report does not purport to be a complete statement or summary. For the purpose of the FSA rules, this report and related services are not intended for retail customers and are not available to them. The products and services referred to in this report may put your capital at risk. Investments, persons, matters and services referred to in this report may not be regulated by the FSA. CBAE can clarify where FSA regulations apply.

Singapore Investors: This report is distributed in Singapore by Commonwealth Bank of Australia, Singapore Branch (company number F03137W) and is made available only for persons who are Accredited Investors as defined in the Singapore Securities and Futures Act and the Financial Advisers Act. It has not been prepared for, and must not be distributed to or replicated in any form, to anyone who is not an Accredited Investor.

Hong Kong Investors: This report was prepared, approved and published by the Bank, and distributed in Hong Kong by the Bank's Hong Kong Branch. The Hong Kong Branch is a registered institution with the Hong Kong Monetary Authority to carry out the Type 1 (Dealing in securities) and Type 4 (Advising on securities) regulated activities under the Securities and Futures Ordinance. Investors should understand the risks in investments and that prices do go up as well as down, and in some cases may even become worthless. Research report on collective investment schemes which have not been authorized by the Securities and Futures Commission is not directed to, or intended for distribution in Hong Kong.

All investors: Analyst Certification and Disclaimer: Each research analyst, primarily responsible for the content of this research report, in whole or in part, certifies that with respect to each security or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about those securities or issuers; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that research analyst in the report. The analyst(s) responsible for the preparation of this report may interact with trading desk personnel, sales personnel and other constituencies for the purpose of gathering, synthesizing, and interpreting market information. Directors or employees of the Group may serve or may have served as officers or directors of the subject company of this report. The compensation of analysts who prepared this report is determined exclusively by research management and senior management (not including investment banking). No inducement has been or will be received by the Group from the subject of this report or its associates to undertake the research or make the recommendations. The research staff responsible for this report receive a salary and a bonus that is dependent on a number of factors including their performance and the overall financial performance of the Group, including its profits derived from investment banking, sales and trading revenue.

Unless agreed separately, we do not charge any fees for any information provided in this presentation. You may be charged fees in relation to the financial products or other services the Bank provides, these are set out in the relevant Financial Services Guide (FSG) and relevant Product Disclosure Statements (PDS). Our employees receive a salary and do not receive any commissions or fees. However, they may be eligible for a bonus payment from us based on a number of factors relating to their overall performance during the year. These factors include the level of revenue they generate, meeting client service standards and reaching individual sales portfolio targets. Our employees may also receive benefits such as tickets to sporting and cultural events, corporate promotional merchandise and other similar benefits. If you have a complaint, the Bank's dispute resolution process can be accessed on 132221.

Unless otherwise noted, all data is sourced from Australian Bureau of Statistics material (www.abs.gov.au).