



Coffee - Outlook for 2007

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As the commodity markets experience some turbulence, coffee appears to be in for a rather smooth ride in 2007.

Smaller production from Brazil, a 2007/08 production deficit, and increased world consumption are all factors cited by bullish traders as to why coffee prices should rock in 2007. While we believe coffee prices could see an increase in 2007, we feel rallies will be limited. There is consensus belief that a bull market is imminent in Coffee.

While coffee is grown in many countries across the globe, Brazil is the world's largest producer and exporter of coffee by far, responsible for approximately 1/3 of the world's total coffee production in any given year and accounts for the majority of the higher quality Arabica Coffee traded at the NYBOT. Thus

developments in the Brazilian crop have a substantial impact on coffee futures prices at the NYBOT.

The bulls are pointing to 2007's expected 31.5 million bag Brazilian crop as reason enough to buy coffee now. After all, it is a substantial decrease from the massive 48 million bag 2006 harvest and we expect Brazilian coffee exports to drop as much as 10% in 2007 as a result.

While this may be true, this viewpoint does not take into account the excessive supplies in storage left over from the 2006 harvest. The South American coffee harvest typically wraps up in October. Most of this coffee is still sitting in Brazilian warehouses looking for a buyer. But Brazil is becoming much more active in exporting at current price levels. In December, coffee exports from Brazil were up 26.4% over last year at the same time. The bulk of these supplies will be hitting the world market over the next 2-3 months, which should keep a lid on runaway coffee prices in the near term.

In 2007, the world is expected to produce 117 million (60kg) bags of coffee while consuming 121 million bags. True, this is a deficit of 4 million bags. However, this figure does not take into account all the coffee in storage across the globe. In addition, the bulls may not consider that 2006 saw a production surplus of nearly 6 million bags.

In addition to last year's burdensome supplies, the market has at least partially already priced the expected production decline in 2007. Coffee prices started climbing in late 2006 around the time the first private estimates for the 2007 crop were made public. Indeed, coffee prices have climbed nearly 30% since September of 2006.

We are not necessarily bearish coffee prices over the next 3-4 months. The mild production deficit of 2005 produced only moderate price increases (prices topped out at \$1.37 per pound) and coffee has not traded above \$1.40 since the freeze scares of the late 90's (it is currently early summer in Brazil).



Technicals



The Active coffee contract in NYBOT has begun the year well staying above \$ 1.20. Though the overall outlook remains positive, it won't be a smooth ride for coffee prices. Crucial trend line support is at \$ 1.10-11 levels.

Elliot wave analysis used to forecast prices, also confirm an impulse move in progress. The rally that began from 42c in 2001 is in the middle of the impulse showing signs of a fifth wave in the beginning. Ideally, we expect a corrective down move to find good support near the \$ 1.10 –1.11 levels and climb higher to our target of \$ 1.55-1.60 levels.

Euronext (Liffe) Coffee outlook for 2007

LIFFE robusta futures ended calendar year 2006 relatively strongly given the face value of prospects of record world 2006/07 robusta production and a bumper 2006/07 Vietnamese crop. The second month closed Q4 at \$1,590/tonne, which was \$52 higher than its close of end-Q3 and a notable 34.4% up on the close of \$1,183/tonne at the end of calendar year 2005.

On the fundamental front, improved robusta prices during 2006 can be pinned on tight world 2005/06 supply and the prospects that despite record 2006/07 world robusta production, there is likely to be a minimal output surplus given strong global robusta demand growth.

The drop in robusta stocks clearly shows the tight situation that the world robusta market has been facing. LIFFE certified stocks had eased every fortnight from the middle of November 2005 until towards the end of Q3 of 2006.



A keen eye will be kept on Vietnamese exports in Q1 of 2007, with the first quarter of any calendar year usually showing a notable pick-up in shipments from Vietnam.

Aside from current focus on 2006/07 output, attention has been turning to weather conditions for the next 2007/08 Vietnamese crop and key flowering occurs February/March. There have been reports that there will be drier than normal weather in the first few months of 2007, which if turns out to be the case could have an adverse impact on 2007/08 production □ a season that, at present, is projected to see a drop in production anyway due to cyclical factors after bumper output in 2006/07.

Technical



Liffe Active contract is also displaying the same impulsive tendencies. The difference though is in the magnitude of the downside correction to take place. A sizeable correction can be expected in Robusta futures.

A triple top followed by a divergence in the indicators warn of an impending fall to \$1350-75 levels from where prices are expected to rise higher. However, an expected move below \$1350 will result in a deeper fall to \$1100, being the trend channel support point.



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