

The jury is still out on the impact of El Niño

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Weather has always been a key factor influencing the outlook for major commodities, especially agricultural commodities. The arrival of El Niño in June 2023 has led to a wide divergence in the performance across agricultural commodities. As discussed in our previous blog "[What does El Niño's return mean for commodities?](#)", the effects of El Niño include specific wind patterns across the Pacific Ocean, heavy rain in South America, and droughts in Australia and parts of Asia including India and Indonesia. This is why certain commodities such as cocoa, sugar, soybean oil and grains tend to depict a price positive environment following an El Niño phenomena. So far in 2023 – cocoa, sugar and cotton have been key beneficiaries of the El Niño weather phenomena whilst wheat, corn and soybeans have posted a weaker performance.

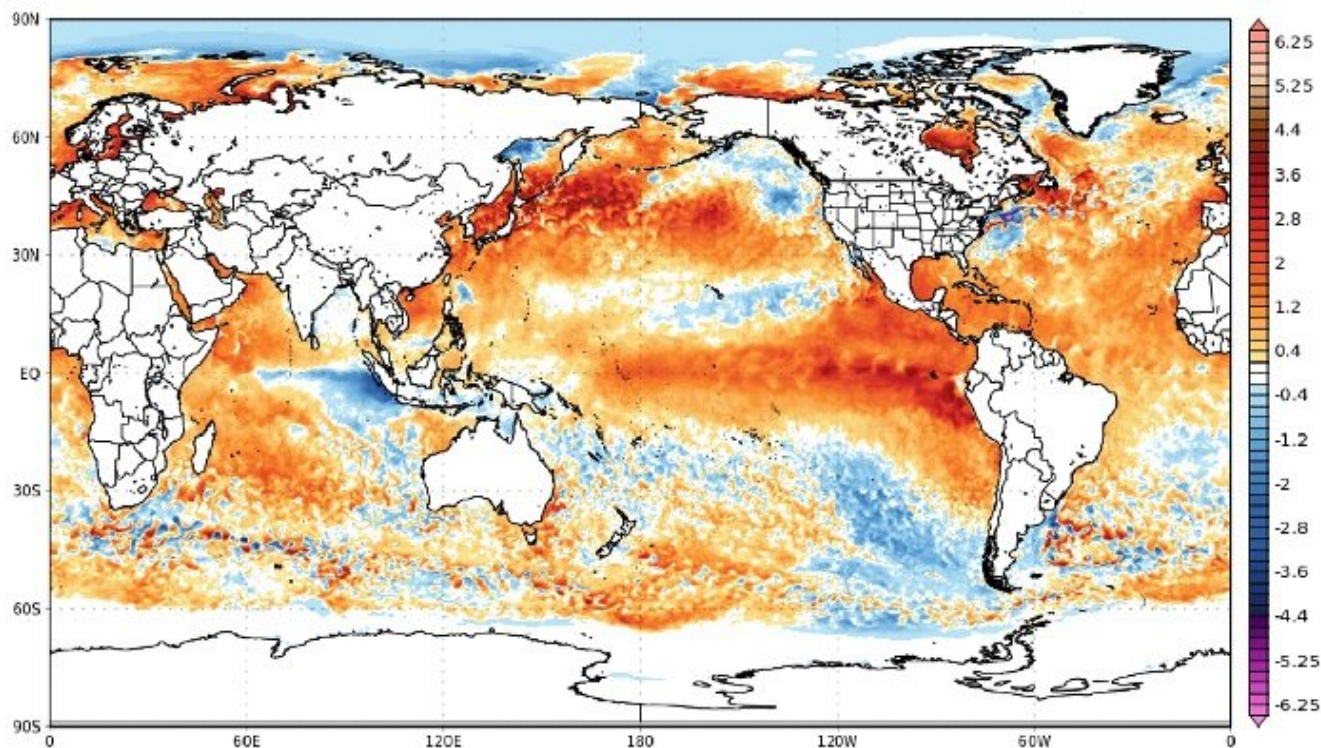
Source: Bloomberg, WisdomTree as of 5 October 2023. Please note the bars in teal represent agricultural commodities while the bars in black represents the rest of the complex. Historical performance is not an indication of future performance and any investments may go down in value.

How does the El Niño currently look in nature?

With the National Oceanic Atmospheric Administration (NOAA) forecasting more than a 95% probability of El Niño continuing through the Northern Hemisphere winter through January - March 2024, chances are high that we continue to see further weather abnormalities over the coming months. There is now around a 71% chance that this event peaks as a strong El Niño this winter¹.

The main El Niño monitoring metric showed the average sea surface temperature in the central and eastern equatorial Pacific Ocean—was 1.3°Celsius (2.3°Fahrenheit) above the long-term average in August, up from 1°C in July¹. The whole ocean (Pacific, Atlantic, Indian, Arctic and Southern Ocean) was over 1°C above the 20th-century average in August, the first time that's happened in the 174-year record².

Figure 2 : NOAA Coral Reef Watch Sea Surface Temperature Anomaly (degrees)



An important aspect of ocean changes is the sea level height. Presently there is a strong ocean sea level rise in the easterly tropical Pacific, a clear sign that El Niño is active³. The changes in the ocean heat content are mainly due to the expansion and rise of the strong subsurface warm pool. This also causes the sea level height to increase, usually associated with warmer waters.

Agricultural commodities price response to El Niño will vary

The growing of agricultural products is sensitive to weather patterns. For some crops, El Niño could boost production, while for others it could damage production. This is because the drift in warm water across the Pacific moves' evaporation and rain such that Southeast Asia and Australia tend to get drier while Peru and Ecuador tend to receive more precipitation. Should the weather event intensify, it could be a significant catalyst for price gains in cocoa, soybean oil, sugar, and grains as discussed in [“What does El Niño's return mean for commodities?”](#) blog.

Cocoa and sugar lead the commodity scoreboard in El Niño 's slipstream

Cocoa has been an important beneficiary of the El Niño. The concentration of supply in West Africa, nearly 70% of global supply⁴, underlines the outsized impact of the region's weather patterns on the world's cocoa supplies and prices. The emerging El Niño is likely to hamper the next main crop that begins in October as it tends to bring dry and hot conditions to West Africa. This comes at a time when heavy rains in West Africa have triggered the Cocoa Swollen Shoot Virus Disease (CSSVD) and the spread of Black pod diseases. The diseases alongside the high cost of inputs, have not spared the two leading producers (i.e., Côte d'Ivoire and Ghana) and affected their volume of production⁵. Despite high cocoa prices, demand evident from cocoa grinding continues to rise in Asia and the US⁶.

Sugar has also benefitted from the emergence of El Niño as lower rainfall in Asia, namely India and Thailand have resulted in lower sugar production. However, we expect further upside for sugar prices to be capped as Brazil (the world's largest producer and exporter) is likely to fill the gap. Production in Brazil's main Centre- South (CS) growing region between the start of the crop year in April and mid-August already amounted to 22.7mn tons, which is up 22% over the same period last year⁷. What's more, the sugar mix increased to 51.1% in H1 September, up from 50.7% in H2 August signalling that Brazilian mills continue to favour sugar production over ethanol amidst higher sugar prices⁵. Extreme weather conditions in China have reduced domestic supplies. China is also planning to release 1.3mn tons of sugar from its reserves, to increase domestic supplies and stabilise prices⁴.

Wheat prices stand to benefit as key producers to face the impact of El Niño

On the other end of the spectrum, grains (namely wheat, corn and soybeans) continued to struggle as the United States Department of Agriculture (USDA) outlined a more bearish outlook for corn while bullish for wheat. The corn harvest is progressing well with 15% of the crop harvested, up from 11% at the same stage last year and also above the five-year average of 13%⁸. Moscow's revocation of the secure grain's corridor through the Black Sea, alongside the Russian attacks on key infrastructure along the Danube River in Ukraine, have lowered grains exports from Ukraine by 25% over the prior year. Yet wheat prices have fallen sharply this year as Russia's record crop is enabling it to ship huge volumes to world markets.

The Grain Industry Association of Western Australia has likewise reduced its crop forecast for the region by 1.5 million tons to 8.5 million tons. Most of Australia is expected to face warm and dry conditions over the next three months⁹, so further downward revisions are on the cards. Argentinian farmers are also battling with a drought. The Buenos Aires Grain Exchange has already warned that the crop in 2023/24 could be impaired if there is no rainfall in the near future. As the prospects for the wheat crop amongst major producer countries are becoming increasingly weak, we expect wheat to benefit from these rising tailwinds.

Conclusion

There has been a wide divergence within the commodity linked Exchange Traded Funds (ETF) flows since the start of the year. Agriculture linked ETFs have seen US\$458mn worth of outflows while energy linked commodity ETFs raked in US\$1.2Bn worth of inflows¹⁰. Agriculture linked commodity ETFs likely faced outflows owing to profit taking. We continue to expect plenty of upside in select agricultural commodities as the impact of the El Niño is likely to intensify over the upcoming winter.

1 September El Niño Southern Oscillation outlook

3 As described by NASA as of 31 August 2023. Kelvin waves are 2 to 4 inches high at the ocean surface and hundreds of miles wide moving from west to east along the equator.

4 Statista

6 Bloomberg as of 30 September 2023

7 UNICA the Brazilian Sugarcane Industry Association

8 USDA as of 26 September 2023

9 Bureau of Meteorology Australia

10 Bloomberg from 31 December 2022 to 29 September 2023

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