European banana market in 2014

Published on 26/01/2015 - Published by LOEILLET Denis
FruITrop n°229, Page From 48 to 62
Free

Carpe diem

Without going over the top, the world banana market confirmed its good shape in 2014, both in terms of volumes and import prices. Intra-annual volatility is at rock bottom on organised markets such as Germany. Conversely, the more speculative markets, more open to competition, are seeing their instability persist, or even increase (Poland and Russia). In general, everything seems relatively under control. However, conditions could change for the year 2015. They seem more hostile and less in favour of price renewal, especially on imports. Indeed, the supply should see a very considerable increase. So the objective will be to consolidate the good consumption levels achieved over recent years, while protecting the added value of the product.

Informations
- Product(s) : Banana
- Rubrique / Thématique : Economic analyses
- Country : Europe
- Keywords : Climate, Trade, Consumption, Export, Import, Price

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“Great deal: world banana market in good working order”. This newspaper ad style wording provides a good summary, without going over the top, of the state of the international banana market in 2014. It may seem out of synch with a cycle that has been favourable to the world banana market as a whole. There are three reasons for this. The first is that the market held up well in 2014, but without scaling any heights. The benchmark price in Germany (average, not weighted by volumes) amounted to 13.5 euros/box, i.e. slightly down on 2013 (-2 %) or the three-year average. The 2012 record of 14.1 euros/box is a long way off. The second reason is that the price stability over the past three years has made market solidity almost a banal occurrence; just a matter of course. Finally, the operators, as well as observers like us, can see a 2015 season set to be at best complicated, for the optimists, and potentially catastrophic for the pessimists. Yet let’s not anticipate the conclusion of this article.
EU: nearly half a million tonnes more

This early-year bulletin traditionally focuses on prices. The volumes report will come a little later, when the Customs have given their verdict (see forthcoming FruiTrop no. 231 of April 2015). The fact remains that the consumption data in both Europe and the United States are indisputable. Over the last twelve recorded months (November 2013 to October 2014), the EU consumed nearly 5.6 million tonnes of bananas, as opposed to 5.3 million one year previously, and 5.1 million two years ago. Specifically, the EU has absorbed 464 000 tonnes more in two years, within a practically unchanged scope, both in terms of population and Member States. Croatia, the last country to join the Union, consumes barely more than 50 000 tonnes per year. So we can rejoice at this increase in consumption for a so-called banal product, supposedly ailing. Except that this minor miracle needs to become routine. In other words, consolidation of these volumes, without any deterioration in value, is an absolute necessity, whatever the state of the banana supply and competing fruits supply: or whatever the politico-economic vagaries which also affect the sector, but over which the sector has no control - exchange rate, customs duty, etc.

We are getting to the crux of the issue. Let’s review the various factors which affected the banana sector in 2014. We will finish with a few prospects for 2015, some of which, as every year, will be purely divination.

A great classic: climate vagaries

Let’s start with a factor associated with the banana sector itself, which has had a crucial influence. In 2014, as in the preceding years and decades, climate vagaries strongly shaped the market. According to an old farming principle, extendible to banana growing, the supply is regulated only by the climate or political instability, and 2014 brought us two major events. In order of importance, we can point to Colombia, which lost 16 000 hectares of banana trees in early July in horrendous winds, and Côte d’Ivoire, where nearly 1 000 hectares were literally engulfed by the waters in the Níéký zone, also in July. The return to production timescale was not the same in the two cases. A tornado does not necessarily require replanting, but the plots need to be cycloned (damaged plants cut back without destroying them). Conversely, prolonged flooding means starting over from zero. And this observation has some significance in terms of the rapid return of Colombia to the markets, and therefore for the cyclical conditions in 2015.

This did not mean that the markets were deserted and therefore in shortfall. Consumption continued to grow. Ecuador, the number one supplier to the EU, recovered and actually exceeded its full potential, with growth rates of its exports to this market touching on 12 %! The same applied to Costa Rica and the Dominican Republic. No, we did not need to lament long queues of consumers desperately seeking bananas! Quite the opposite, we dare not imagine the situation if all the sources had fulfilled their production promises. With the exceptions setting the rules, we see every year that vagaries regulate the supply. If they only last!
The German fortress

The slackness of the market at certain periods (especially the second part of the year) is one of the symptoms of this congestion or this incipient saturation. We might also observe that certain European markets are perhaps set up to ride out these pressures slightly less well than the others. Typically, the German market is extremely closed off, and led by the reference price decided and set by the discounter every quarter. Is that a good or bad thing? It is hard to say. From experience, we know that the reference price is a genuine glass ceiling which is never ever exceeded, and in most cases never paid at the stated value. Regardless of the state of the market or quality of the products on offer, the law of price is in play… ultimately, a law with an upper limit. There is no guarantee of resistance to falls, since reductions, discounts or rebates are common practices. Nonetheless, the fact that this market is so sealed off and not very willing to accept newcomers does not guarantee better product valuation. The diktat of the German supermarket sector still applies, except that the market is divided between few hands.

The French market is fairly different since it is highly competitive, diverse in terms of operators, with few contracts and open to all-comers in terms of sources. It is also hilarious to note that France, which for the past two decades has set itself up as the defender of a regulated, controlled and balanced market, has emerged from so many years of the banana CMO as one of the markets most open to competition. As for Germany, such a fervent advocate of market deregulation, it has managed to ring fence its market, to the point that the supermarket sector is now its sole conductor.

In search of lost volatility

The heightened sensitivity of the French market to balance shifts, often described in these columns, is one of its major traits, often for worse and rarely for better. This no longer seems to have been the case for several years. The price peaks are no longer ever reached, with a grey outlook at all stages of the trade. Volatility in France reached a new low in 2014. The standard deviation calculated on the weekly green price series fell to 0.04 euro/kg in 2014, as opposed to 0.05 euro in 2013 and 0.07 euro in 2012. Translated into a percentage, it shows that volatility in France has dropped from 41 to 25 % at the import stage. The trend is the same at the wholesale stage (yellow banana), where volatility went from 27 % in 2012 to 15 % in 2014. Exactly the same trend can be seen in the retail prices, volatility of which was also down 15 % in 2014, after reaching 29 % in 2012.

As we were saying, Germany, organised completely differently, is also seeing a fall in its market volatility. This is the effect of quarterly
contract setting, which tells on the market price lists. From 66 % in 2011 volatility has dropped to just 11 % in 2014 - a historic low.

It is a completely different story on the Polish market, with extreme and unflagging volatility at the import stage. It even increased in 2014, up to 61 % from 54 % in 2013. Nonetheless we are a long way from the crazy years of 2011 and 2009 when volatility was in excess of 90 %.

Although an obvious point for many, this is the manifestation of a two-speed European market. The first is fundamentally stable, with Germany being the absolute example. The second is a true commodity market, i.e. unstable. Germany and France are of course responsible for this state of affairs, while Poland is to some extent the last resort of the European market: the one they turn to when the supply is swollen, and which most often at any price is prepared to absorb large volumes. When its absorption capacities are saturated, the European exporter countries (France, Germany, Italy, etc.) find themselves back in the firing line, and are quickly and heavily destabilised, in a perfect example of the domino effect.

The worrying Russian market

This year things went relatively well given the pressure exerted by the quantities. However, a catastrophe scenario is perfectly possible for 2015. Especially since there are external events (outside the EU and the sector) which have not had serious repercussions for the moment, but which are of concern for everyone. I am referring to the situation in Russia, which is critical for various reasons. In response to Europe’s protests after the annexation of Crimea, Russia has banned European fruit and vegetable imports since the beginning of August 2014. While it normally imports some 750 000 tonnes per year of Polish apples and pears, not one kilo is getting in, despite attempts by European exporters to get round the embargo. On top of this came a bumper European apple production season. There were fears that the reflux of Polish apples could increase competition on the European fresh fruit market. This has not yet been the case, though the danger still looms because when Russia imports this fruit in large quantities from Poland, it does so above all in Q1. The risk level remains high for the banana market, which is the leading competitor of the apple.

This Russian newsflash also features the collapse of the rouble and an unprecedented fall in income from oil and gas. These two factors are not necessarily hitting Russian banana consumption with the same force and on the same time scale, but they are two powerful brakes. The rouble depreciated by more than 40 % against the dollar in 2014, increasing the banana price on the Russian market by the same amount. A revealing indicator is that over the last two months of 2014, imports fell by 8 %, i.e. 480 000 fewer boxes. In spite of all this, this is not a catastrophic drop, and the banana remains the most competitive product in the fruit section. At constant rouble value, the banana price at the retail stage has actually fallen abruptly, losing 40 % of its value between 2000 and 2014. The banana is ultra-competitive. The price gap, again at constant rouble value, against the orange and apple remains substantial, at + 16 % and + 27 % respectively.

Coming soon, 1 dollar to the euro

So the “Russian” risk is difficult to evaluate. Conversely, the uncertainties fall away when we look at another external factor: exchange rate variations. The euro has been on a downward gradient since August 2014. Against the US dollar, the European currency lost 15 % of its value between its high point of 2014 and the low point reached in early January 2015. If we compare the two currencies by purchasing
power parity (method used in economics for drawing a comparison between countries of the purchasing power of their currencies), at a level of 1.18 (as was the case in early January) the euro has a purchasing power abroad much less than that of the US dollar. And there is doubtless more to come. Indeed, three big analysts — Deutsche Bank, Barclays and Goldman Sachs — recently estimated that the fall in the euro is inexorable, and that it could well be trading at less than 1 USD by 2017.

This is of course a powerful deterrent for non-euro zone suppliers. It automatically raises the price per box of dollar bananas bound for Europe. It is hard to gauge the current impact of the fall in the euro, but if analysts’ predictions come true, it will be more favourable to produce in the euro zone than the dollar zone. The fact remains that a large proportion of the inputs and energy is paid for in US dollars.

Finally, European Customs duty converted into the national currency of the main Latin American suppliers will fall even more steeply than specified by the treaties. Ecuador, which has a dollarized economy, to the point of abandoning its currency in favour of the US dollar, is taking advantage of this. This is also the case for Costa Rica. Yet the reverse applies to Colombia, which instead of seeing the cost of Customs duty fall in its national currency, is seeing a slight rise. Except that Colombia, whose currency is valued higher than the euro, reaps additional income when it sells to Europe. With the value of each box of bananas four to five times that of the Customs duty, Colombian exporters are getting a very powerful boost from the fall in the euro. The reverse applies to Ecuadorian and Costa Rican operators.

So it is no accident that Ecuadorian operators are fiercely opposed to the government’s wish to raise the price per crate of bananas by 5.3 % for 2015, up to 6.32 USD. The interprofessional association for exporters (AEBE) can clearly see the danger in a loss of Ecuador’s competitiveness, which though benefitting from falling energy prices, is seeing other costs rising (+ 4 % for the minimum wage, toll on the Panama Canal, etc.).

In terms of factors of influence, the all-time classic is of course the state of competition in the fruit section. While 2013 was a godsend for the banana operators, due to a catastrophic European pip fruit harvest in 2012, the situation was completely different in 2014. The 2013 apple harvest was back to average, while the 2014 harvest was bigger still, right across Europe. The citrus season was normal, with some poor sales of easy peelers at the beginning of 2014 (2013-14 harvest) and the end of 2014 (2014-15 harvest). So this year we are struggling to explain the relative good health of the banana sector by the poor health of the competing sectors.

banana exchange rate

Customs duty: find the effect

What about the political aspect of the banana report? By which of course I refer to the customs duty taken on the banana imports from (non-ACP) Latin American countries. Well, everything is changing for the better (see inset)! The degression is working well. Practically all the countries will be at 110 or 111 euros per tonne by the end of 2015, once the last signatory, Ecuador, has completed the agreement ratification process. This may seem bizarre, but we must recognise that the effect of this fall in duty, which was at 176 euros/tonne in 2009, is vague. It is concealed, mixed, combined with other factors, such as exchange rate, the price of energy, climate vagaries, supply of competing products, etc. Except that ultimately it has more than halved since 2009. Let’s take the example of Costa Rica. In 2009, the Customs duty in local currency represented one quarter of the calculated revenue at the import stage; at the beginning of 2015, it now represents just 16 % of the value of the product. All things otherwise being equal (price and exchange rate unchanged), it will barely exceed 10 % in 2020. While it is impossible, for now, to draw a conclusion and determine a cause-effect relationship, a direct link between the state of the market and fall in duty, it is unimaginable that there will be no repercussions. It is a bit like a dam gently filling up without any effects being felt downstream, until the structure, once filled, cracks open to release torrents of water and mud.

We will make no comment about the non-effects such as the invasion in Mozambique of race T4 causing the deadly Panama disease, or the Ebola risk for West African fruits. While in the first case the threat is real, it should be considered rather medium or long-term (contamination risk); in the second case (Ebola), the industry has fallen foul of mud slinging based on rumour and stupidity. As for El Niño, it faded away quietly, although we can currently observe an abnormal drought in one part of Colombia.

As regards the big capital operations, we need to sort between proven fact and rumour. In the realm of the certain, the major event is the takeover of the Chiquita empire by Cutrale (the Brazilian orange juice magnate). But we need to read between the lines of this event, and ask ourselves how will the unfortunate rejected groom, the European company Fyffes, react? In this respect anything is possible. Which further fuels the rumour of a possible friendly or unfriendly alliance with a European-scale operator in difficulty, which could in geostrategic terms supplement the Fyffes portfolio in both imports and production. 2015 could be as lively a year as 2014 based on the abortive Chiquita-Fyffes merger.
There are just a few months left before the customs duty levied on Latin American imports is the same across the board. Ecuador signed an agreement in July 2014 enabling it to join the programmed reduction in duty already enjoyed by eight dollar banana suppliers (Costa Rica, Panama, Honduras, Guatemala, Nicaragua, El Salvador, Colombia and Peru). While Ecuador has signed the agreement, its ratification is pending, and the process could be completed this autumn. The customs duty levied on Ecuadorian bananas would then instantly drop from 132 to 111 euros per tonne, as opposed to 110 euros for its fellow Latinos. This small difference of 1 euro/tonne dividing them is doubtless due to a whim or a gaff by the negotiators. The degression movement will bring down the duty to 75 euros in 2020. There is still a fundamental step to prepare for, which must not be mishandled: the rendezvous clause scheduled for 2019, to take stock of the effects of the duty, which will ultimately have been divided by 2.3 since 2009. At this point the structural effects will need to be sorted out from the cyclical effects. Given the atypicality of the global supply, this is a titanic challenge, but is worth the effort.

In summary, we can consider this 2014 season, when the market was dominated solely by climate vagaries inside and outside the banana sector, as a year of transition toward 2015, a year which should be marked by a steeply rising supply. Indeed, the production potential is in place, and is actually in a rising phase worldwide, from Africa to Ecuador. It seems fanciful that European consumption is rising again by 300 000 or 400 000 tonnes, and that the other consumption zones are either in a consolidation phase (United States), or threatened by deceleration (Russia). The United States should round off the year 2014 with a net growth of just 1 %, while Russia will no doubt be well below its record from 2013.

So the challenge will be to consolidate, under good conditions in terms of value, the volumes consumed and to withstand the supply pressure, which will only increase. For the euro zone, we can count on a protective effect of the exchange rate against the supply from more or less dollarized countries such as Ecuador or Costa Rica. Things will be quite different, as we have seen, for Colombia, which is recovering its competitiveness margins. So the key is to hold on this year, i.e. consolidate the volume consumed while safeguarding the added value of the product! For geometry enthusiasts, this equates to going from the impossible problem of squaring the circle to the possible problem of squaring the lemniscate* (one of the Devil’s curves).
though impossible for the circle, the lemniscate (∞ shaped curve) can be precisely squared: its area is equal to that of two equal squares, the side of the squares being one of the radii of the lemniscate.

banana cost