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## The Region Gets A Coffee Break With Caveats

by LADB Staff

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The coffee crisis of 2001-2002 (see NotiCen, 2002-08-01) and beyond appears to have abated in Central America as world prices have at least doubled over the past couple of years. The benefit to Central America comes in large measure from the kind of coffee grown in this region, Arabica. It is this higher grade of coffee that has seen remarkable recovery as world tastes and the commercial strategies that shape them favor the region's product. The common Robusta coffee bean, the one sold in the mass market, has not fared well during the same period.

Higher prices in Central America, however, have not benefited the growers who suffered most during the crisis. The market has consolidated and changed, and many of those least able to compete have been forced from the field.

### *Technical market*

While flushing out the less efficient producers has contributed to the boon for the more efficient, it is not even certain that these stronger players will continue to see increases. Prices at this time are, according to analysts, driven by the technical aspects of the market, rather than the fundamentals. That means traders are more interested in the patterns of price fluctuation than in how much coffee there is. Speculators have been accumulating futures contracts, thus contributing to the rise, while the cash market is lagging.

Traders noting this widening differential have stepped aside for the moment, leading the Weekly Coffee Market Outlook for April 11 to suggest, "A long liquidation trend could pull the market lower until cash market differentials signal that the market is at a value zone." International Coffee Organization (ICO) executive director Nestor Osorio held a similar view in March, when he said, "According to information I have received from several sources, investment funds that have nothing to do with coffee have big positions in the futures markets and have contributed to this price rise of the last weeks."

### *Fundamental market*

On the fundamental side, that is, the segment of the market having to do with the actual availability of coffee, world demand has risen at an annual rate of 1.5% since 2001, mostly attributable to increased consumption in China, where consumption is rising at a 15% to 20% rate. Meanwhile production has fallen during the period by about 16%, with a slight upturn toward the end of 2004.

However, falling production has been offset by high inventories, about 20 million bags in consuming countries, and another 20 million, or thereabouts, in producing countries. This overhang, according to Osorio, exerts additional downward pressure on prices. Central America has reduced production markedly. The most recent harvest was barely 70% of that of 2000.

El Salvador's output has shrunk by 45% during this period; Guatemala has dropped 28%. Costa Rica, Honduras, and Nicaragua have slipped by about 20%. But there are indications that production is turning around. In Guatemala, exports are significantly higher than last year, 15% according to the Asociacion Nacional del Cafe (ANACAFE). They shipped 424,580 60-kg bags in March 2005, up from 368,693 in March 2004.

For the current coffee year, October to March, exports are up 9% from the previous year, when they shipped 1,309,768 bags. This year the number was 1,428,565. During the crisis period, a number of strategies have been tried (see NotiCen, 2003-10-16). A dash to quality has raised export standards and at the same time driven out marginal producers, especially in El Salvador, where half the coffee was grown below 800 meters of altitude, an area of low-quality yields. Some producers have moved to niche markets, producing organically grown coffee, others have joined co-ops, and still others have sought better prices in the fair-trade market.

### *Fair trade unintended consequences*

But the fair-trade strategy has presented unforeseen glitches for producers attracted by a guarantee of higher prices. The marketing scheme allowed eligible growers to sell coffee at a guaranteed price of US\$1.26 a pound, but when the cash price went higher than that, producers sold into the standard market. Now they have no inventory to satisfy their commitments to the fair-traders.

Said one grower who did not want to be named, "The price of coffee went up so much that everyone sold to the coyotes (profiteers) and there is no coffee left for fair trade. How's that for a twist? Lesson one: it is not low prices, but volatility that is the problem. Lesson two: we didn't really do scenario planning. Lesson three: we have to find US buyers that pay so well that no commercial price hike can touch us." This producer did not mention lesson four: business is business. Prices have declined so much since the growers sold that they can now buy coffee on the cash or futures market to satisfy their fair-trade contracts at the US\$1.26 price and make a windfall profit.

Another strategy has been the creation of contests whereby international testers identify the best of the coffee grown in a particular country and then that coffee is auctioned off at enormously high prices. This practice has a beneficial effect on the region's reputation for great coffee and also results in a competitive atmosphere that helps keep low-quality producers from swelling the harvests. Many of these latter producers have not only left the coffee business, but they have left their countries as well, headed for the US where they have better earning opportunities.

### *Governmental opportunism doesn't sit well*

As this has happened in El Salvador, the enterprising government has approved a plan to recover some 60,000 hectares of abandoned coffee farms, provoking the fury of small and medium producers who do not want new loans but rather help with their old loans. The Foro del Cafe, to which these producers belong, released a statement to the media saying the recent price recovery "has provoked a series of irresponsible declarations on the part of the government and private banks." The Foro maintains that improving prices have not lessened their indebtedness, and they are still not able to

pay the debts they have already incurred. "The seven years of crisis have brought us, as a sector, to an indebtedness that is above US\$360 million," read a statement printed in the largest daily newspaper, El Diario de Hoy, at the Foro's expense.

Salvadorans are not the only producers in the region to endure the agony of watching prices rise while being unable to jump on the bandwagon. In Panama, coffee grower Verisimo Martinez said, "There's great optimism among producers, and we are sure that in the next three years we will get an upturn that will let us turn a profit." But he added that many cannot rehabilitate their plantations because they are already buried under payments on the loans acquired during these last lean years. "We need soft loans that will allow us to pay our debts and continue our activities, generating jobs and contributing to the socioeconomic development of the region," Martinez said.

Martinez and others might get some help. Belisario Adames, director of the Banco de Desarrollo Agropecuario (BDA), said the BDA is working on a plan to ease the burden. "We're not going to forgive debts, because the law doesn't allow it, but we are going to extend the terms of those loans, and, for those who qualify, we will grant additional funds for them to improve production and pay their debts." Price swings aside, in general, the region's coffee producers can look forward to upward trends in the long run, according to most market analysts, or at least until overproduction pushes the pendulum against them again.

The coffee they produce, classified as "other mild Arabicas" on world markets, is among the most desirable. The value of the Central American product is rising at a much greater rate than is the Robusta coffee grown in Brazil and Vietnam, the world's largest producers. During the last 20 years, Robustas have brought around 65% of the price of Arabicas. In today's market, the cheaper variety fetches scarcely 36% of the price of Central America's product.

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