

THE NEW FACE OF THE CRISIS

Interview with the World Coffee Czar

Today's world coffee problems are different.
The outlook for prices in 2005 is relatively clear.

The world coffee crisis is not over. It has merely changed aspect. The problem now is not one of prices but of debt. The world's coffee growers have not managed to overcome five years of financial difficulties. Farmers in producing countries are now desperately seeking ways of refinancing their debts and governments are trying to find means of getting them out of their difficulties. "This is what all coffee farmers are asking for" said Néstor Osorio, Colombian Executive Director of the International Coffee Organization (ICO) in an exclusive interview with *Dinero*. As Executive Director, he is obviously in a position to understand the situation of coffee farmers.

But to make matters worse, there is a possibility that an improvement in this situation, however slight, could precipitate the next crisis.

Paradoxically, the debt problem gives producers an advantage because cash constraints prevent the expansion of planting. "Most smallholder coffee farmers can cover their production costs but any extra money they earn is immediately used to pay off creditors" noted Osorio. And governments are not interested in encouraging any expansion plans. "At present, policies are directed towards solving debt problems" he added.

The supply shortage has managed to achieve a precarious balance in the market. In 2004, for the first time in five years, there was a supply shortfall of around 7 to 8 million bags. Production was around 106 million bags and consumption around 115 million. But there are still around 21 million bags of inventories in consuming countries, which gives buyers some strength and this means that an increase of 10 million bags in world production – which is not unthinkable – could eliminate the supply shortfall with a devastating effect on prices.

The near future seems clear. "For the remainder of this year we will have firm prices ranging between US\$1.20 – US\$1.35 for Colombian coffee and around US\$1 for the ICO composite indicator price," said Osorio.

This prediction is based on the fact that there are no major reasons to expect an immediate increase in supply. Moreover, the rise in fertilizer prices due to pressures in the petroleum market and the weakness of the dollar, which has reduced export profits in most parts of the world, have helped to limit production.

On the demand side, programmes for increasing coffee consumption in eastern European countries, Russia and China have only just started and promotion programmes in Brazil, which have proved very successful (consumption increased from 7 million bags ten years ago to 15 million bags), will not affect figures in the short term.

There will be greater price volatility this year because international investment funds have once more become important players in this market. "Interest rates are low and commodity

markets are the current investment playgrounds” claims Osorio. This matter is so important that the ICO is undertaking a study to determine the effect of popular hedge funds on the world coffee market. Price increases attributable to market fundamentals have already had an impact. The rest is volatility attributable to speculation” he adds.

The next test for prices will come in June and July, which are months of uncertainty concerning frosts. “There have been no frosts for 11 years and this affects the statistics. Each year that passes without a frost increases the possibility of a frost in the following year,” said Osorio. Further tests are due in September, when the Brazilian crop is assessed in the field, and in December when the official estimate of the crop is announced.

Permanent temptation

But sooner or later there will be some countries and some producers who manage to pay off their debts and find current prices sufficiently attractive to warrant increased production. The ICO warns against the dangers of such a step. “My message is one of caution. We must not repeat what happened in 1994.”

In 1994 a frost in Brazil caused price rises which encouraged new planting. With state financing, Vietnam, which had been a negligible coffee producer, increased its production to 14 million bags. “In 10 years Vietnam managed a production increase that had taken Colombia 100 years to achieve.” The period of good prices ended in a terrible crisis. “This offers a very recent lesson of why we must avoid any increase in planting if there is a frost in Brazil or a serious drought in Vietnam,” he states.