

## Market Report Sisal

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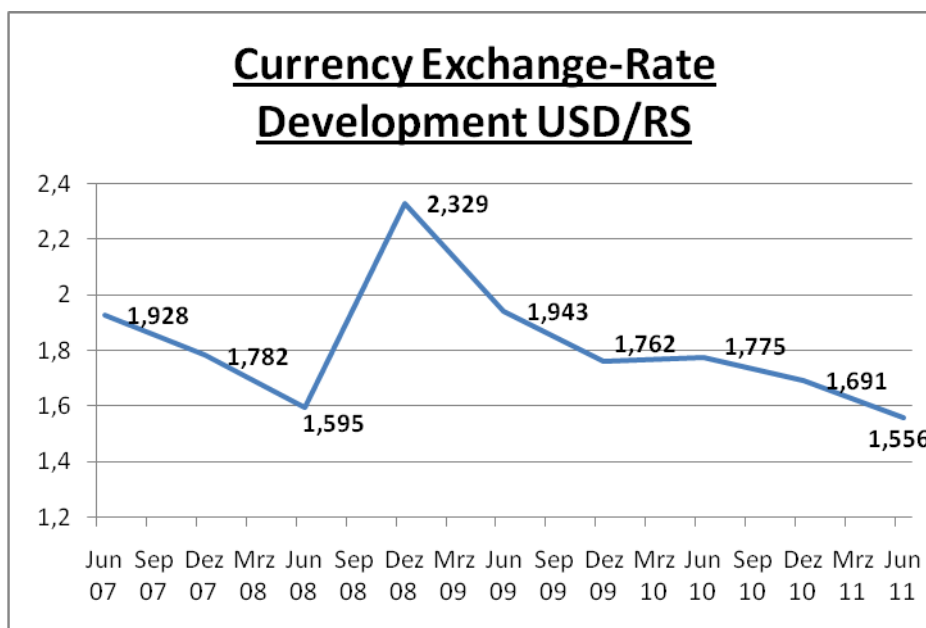
### Brazil

**Booming Economy in Brazil:** Brazil hits the headlines in the finance sections of the newspapers. Economic growth in Brazil has been average 4 percent per year over the last 8 years. Brazil has also proved to be relatively responsible in handling challenges. Its economic success has attracted a flood of money from stagnant developed markets driving up the exchange rate of Brazil's currency, the REAL, against the US-Dollar and threatening the competitiveness of local industry. During the last 12 months the US-Dollar lost 13 % against the REAL. Brazil has responded with the so-called "currency war"- capital and currency controls aimed at curbing the appreciation of the REAL against the US-Dollar; but Brazil has mostly resisted pressure from local industry to take extreme measures, instead imposing a complex system of taxes designed to discourage short term hot money flows.

Fact remains that the REAL is continuing to strengthen his position on the international finance markets (see chart). After the Brazilian Government announced on 27.07.2011 Introduction of measurements aiming at curbing foreign exchange speculation in order to bring down the currency from a 12 years high against the US-Dollar in an attempt to protect local industry, the REAL dropped on 28.07.2011 by 1,7 %. Whether this was just a short-term reaction has to be watched very closely.

The interest rate has been increased to 12,25 % now – representing the fifth increase during this year already. In our Sisal report from March 2011 the interest rate of 12,25 % has already been predicted to be hit - but only until the end of this year.

Brazil's monthly trade surplus shrank unexpectedly to USD 3.1 billion in June, the first drop for six months. Imports fell as aggressive monetary tightening reduced consumer demand, but exports fell more as a strong currency continues to hurt competitiveness. Growth in industrial production was also decelerating to 0.9 % in June compared with 2.7 % in May.





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The Brazilian economy keeps staying strong; the unemployment rate is at a record low. All signs are indicating continuation of a very favourable development of the domestic economy in Brazil.

**All Time High – but already reached the peak?:** Brazil's export of Sisal set a very impressive mark during January and June 2011. Having exported 9.149 mtons in the first 6 months of 2010, this year's export volume of 17.783 mtons represents a staggering plus of approx. 94 % in the same period of time! And this despite the significant appreciation of the REAL against the US-Dollar.

And still export demand continues to exceed availability of Sisal.

Not surprisingly, China has maintained its leading position as the major importer of Brazilian Sisal. In the first 6 months of 2011 China bought 9.359 mt compared with 4.089 mt in 2010 – representing 2011 53 % and 2010 44 % of total Brazilian exports. Portugal is following with 1.771 mt (1.539 mt) on second before Egypt with 964 mt (520 mt) being 3<sup>rd</sup>. Spain and Mexico are on fourth and fifth position with 829 mt resp. 782 mt.

While the prices in East-Africa were taking a slightly smoother way up, the prices in Brazil soared through the roof in the second quarter of the year.

A good title for the Brazilian report could also be “helter-skelter in Brazil” – as the rise of the prices came very fast and the extent hit unexpectedly some players. On the way up, some exporters reportedly refused to honour their contractual commitments, forcing foreign buyers to buy again under duress at re-negotiated, increased prices of course.

Spot lots were on offer, sometimes just for a few hours, in order to test the market and to find out which new price increases buyers were willing to accept. A situation one market player called “stock exchange games”.

The very sharp hike of Brazilian Sisal prices has basically four explanations:

- 1.) The farmers need more money to feed their families due to the high inflation. The target rate to apply 2011 was 6,5 % but inflation rate has already been going up to 6,55 % with upward trend continuing.
- 2.) The exporters need higher prices to make good for loss in revenue in terms of REAL because of the strong appreciation of the REAL against the US-Dollar.
- 3.) Shortages of labour becoming more and more pronounced because farm labour and other labour employed in the North East of Brazil find much higher paid working places in the industrial belt of Brazil, especially in the building industry, and are benefitting from the economic boom in Brazil. (See also separate chapter of this report.)
- 4.) The demand for certain grades of Brazilian Sisal is increasing, since for cost-reasons some Sisal buyers are switching from high priced East-African grades to the qualities of Brazilian origin which is obtainable at lower prices than current prices at which East African Sisal is selling.

The last point is especially valid for the type 1 db, since the demand for this quality is soaring to a peak level.



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While buyers were still hesitating to buy at the time when prices started to rocket upwards they are now slowly returning to the market, reckoning with the possibility of even higher prices in the near future or they are simply compelled to buy in order to keep their production running. Concerning the Agave plants in Brazil good news are being reported, there is enough Sisal to be harvested.

**CONAB to Work on Stabilization of Domestic Situation:** During the first 6 months of this year, CONAB has paid USD 10 mill. subsidies to the Sisal farmers via the exporters. CONAB will continue their subsidy system also during the second half of 2011, even though the farmers are currently getting more than the minimum prices for their Sisal. This decision was a very crucial point for the future price development and therefore the situation is closely watched by all domestic market players. With this measure CONAB aims at granting stable conditions for the farmers in Brazil, as without this measure the small holders could potentially be squeezed by the exporters for lower prices. This internal measurement will not have direct effect on the export pricing situation, but will stabilize the Sisal supply situation on long term. Demand for Sisal on the domestic auctions is huge.

**Work-Force Shortage on Sisal Fields Expected:** Should the employment situation in Brazil stay in favour for the workers, the Sisal farmers may face severe difficulties in the near future to find sufficient work force. Already now, busses full of workers are brought from the rural areas to the urban centres, where massive construction work is going on and workers – even unskilled – are sought for. An unskilled worker on a Brazilian construction site earns with approx. USD 700,00 – 750,00 more money than an experienced worker on the Sisal field whose salary is about USD 250,00 – 300,00. Plus the work on a construction site is still more convenient and could allow a certain career with the perspective for a better income – while career opportunities are rare to find on Sisal fields.

**Trend:** Due to the above mentioned economy facts and the very strong demand for Sisal, stable prices are likely to be expected during the coming 3 months.

### Kenya

**Progress in Kenyan Economy:** Few African countries have made as much progress in the past year as Kenya. Progress is being made on vital infrastructure projects such as a motorway connection between Nairobi and the city of Thika in the north-east of Kenya. Under the patronage of the East African Community, the regional common market has increased trades. Kenya's economy has a predicted growth of 5 % this year. Unfortunately, these 5 % are not enough for the entire Kenyan society. Kenya's young and fast urbanizing population requires a higher economical growth to feed all mouths. The unemployment rate among the young people is still high, their grade of education rather low.

The drought in the north of the country attributed directly to high inflation, since also food-prices are rising. The inflation went up from 9,19 % in March to now 14,49 % in June. Kenya would need more direct foreign investors to enable the economy-growth rates to meet the growth of population.



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Even though, the geographic position of Kenya is obviously ideal for said country to become a trade hub, the current insufficient infrastructure in general and of the Mombasa port in particular does not allow any big steps forward in this direction.

**Sisal - 29,6 % more Sisal Exports:** Until now, the drought has not led to any significant disturbances in the Sisal sector. The export figures are showing that the demand was high and the supply was sufficient. In the first 6 months of 2011, 12.786 mt were exported, compared with 9.861 mt in 2010 – a plus of 2.925 mt or 29,6 %.

Saudi Arabian buyers are still very hungry for Sisal which is mainly used for plastering works. The building industry in Saudi Arabia keeps on booming. Payments made by Saudi Arabian buyers or their representatives are said to be still done on basis “cash on the kitchen table” – supporting this kind of spot business and to make it become more important to smaller Sisal producers in Kenya, who may not want to look for long term business relationships.

Saudi Arabia is ranking as the no. 1 export-country for Kenyan Sisal. With 3.260 mt or 25% Saudi Arabia is ahead of China, importing 1.950 mt. While the volume for China was only slightly higher than in 2010 – in 2011 Saudi Arabia imported nearly 800 mt more compared with last year's volume.

Significantly more volume went also to Morocco, currently being no. 3 export-country. In 2011 Morocco imported 1.624 mt. Spain and Egypt are following on fourth and fifth position with 1.179, resp. 804 mt imported Kenyan Sisal in the first 6 months of 2011.

As reported the rainfall has been very poor. It was 75 % below their long-term means (LTM). In addition to the shortage of rainfalls, the intensity and the distribution in time and space over Kenya was not in favour to the Sisal-producers.

Further negative impact of the drought in the rural areas is also the loss of farm animals, which cannot be fed sufficiently any more. For some farmers and families their livelihood is put at great risk.

**Trend:** A shortage in supply and delay in deliveries must be expected during the 3<sup>rd</sup> quarter of 2011, prices are expected to remain stable with there being perhaps a possibility of an upward trend.

### Tanzania

**Drought to affect entire country and economy:** The worst drought in East Africa since 60 years is also affecting the second largest economy of East Africa – Tanzania.

Tanzania has an installed capacity of electrical power of 773 megawatts. 71 % of the electricity are generated by hydro-power plants, using giant hydro-electric dams.

Lack of rainfall is not only hampering the agricultural output, it has also led to a critical low water level at the Mtera dam and other hydro-power plants. In order to ensure the country's minimum supply with electrical energy, Tanzania's state-run power company Tanesco announced that power supply will be rationalized. Power will be cut for 16 hours per day. However, the supply of critical installations and institutions, such as water-pumps and hospitals, is granted.



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Power-supply is one of the most important factors for the domestic economy. Due to the continuous power-outrages since December, the International Monetary Fund revised its growth rate for Tanzania from 7,2 % to 6 %.

Not surprisingly the inflation keeps increasing and hits the two-digit zone. May 2011 saw an inflation of 9,7 % - in June 2011 it went up to 10,9 %. Housing, water and electricity went up by 18.8 %, food and non-alcoholic drinks by 14 %. The savings ratio is low, since interest rates are not following the inflation.

At this time, the big target of the African Community Monetary Union to create a monetary union with the five EAC partners Tanzania, Kenya, Uganda Burundi and Rwanda by 2012 may be too ambitious. One major criterion is inflation in all countries to be at around 5%, which is by far not the case in all countries concerned.

**Sisal - Drought expected to have impact on Sisal Production from Q3 onwards:** In the first 6 months of 2011 Tanzania exported a volume of 6.522 mt, compared with 6.085 mt in 2010, this represents a plus of 437 mt or 7 %.

This positive figure is getting into a different light, when the total production quantity is evaluated by month. The quantity from May to June decreased dramatically. Since the demand continues to remain at a very high level, this is a very clear point for a reduced supply – mainly due to the drought already.

Since also the machinery in the Sisal production is fed by electrical power, the above mentioned power cuts will have significant effect on the availability and on the prices of Sisal from Tanzania. In accordance to the information from Tanesco, some parts of the country will have power from 8 pm to 6 am, resp. from 6 pm to 11 pm – which are obviously not the normal working times in the Sisal production.

In order to keep the decortication-machines running, diesel-generators may have to be used – supplying electricity at higher cost.

The dams for the hydro-electric power plants are expected to begin filling again once the rainy season gets under way only in September. Until then, short supplies and delays in shipments from Tanzania are likely to be expected.

**Trend:** Tanzanian Sisal will follow the general Sisal trend and will be very stable during the coming weeks.

### Madagascar:

**Madagascar – Unstable Political Situation:** Madagascar and its population are suffering from the negative effects resulting from the non-recognition of the current government by the African Union Organization and the EU. The general conditions have remained very much the same since our last report from Q1 2011 went to press.

**Sisal - The drought still continues to have effect!:** Madagascar exported from January to June 2011 in total 2.840 mt of Sisal. Compared with 2010 figures from the same period, this represents a minus of 45 %, as last year 4.120 mt were exported.



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Major importer of Madagascan Sisal was China with 1.153 mt or 40,6 %. Compared with last year 2.060 mt or 50 % share, this is a slight weaker market position. On the places 2 and 3 are Morocco with 685 mt (342 mt) and Germany with 387 mt (261 mt). Both countries strengthened their position and increased their share from 8,3 % to 24,1 % (Morocco) resp. from 6,3 % to 13,6 % (Germany). Spain lost significant volumes in 2011 (604 mt in 2010 and 282 mt in 2011), but still marks position 4 in the Top-5 ranking, followed by Belgium with a volume of 129 mt. Belgium was not a buyer of Madagascan Sisal in the first 6 months of 2010.

The reason for this drastic decrease of exports is the serious drought that started to hit Madagascar nearly 2 years ago. Major plantations reduced their production to the minimum in order not to risk the quality of the fibre and the productivity of the entire enterprises. For this reason, the supply with Sisal from Madagascar was at very ebb low during the first 6 months of this year.

Now, the weather in Madagascar has changed from one extreme to another: from drought to excessive rainfalls and too little sun! During the first 5 months of 2010 Madagascar had 157 – 291 mm rain on 24 – 33 days. The first 5 months of 2011 showed 604 – 733 mm rain on only 24 – 29 days! Due to the heavy rains, parts of the Sisal could not properly be dried, forcing some Sisal estates to slow down production slightly.

It is estimated, that the situation will stabilize further, so that from August / September 2011 the usual quantities can be made available for the market again. Currently, the qualities from Madagascar are very much in demand; no unsold stocks are reported from Madagascar.

**Trend:** It is expected, that the qualities from Madagascar will be going a similar way like the other East-African qualities. The market for these qualities will stay very stable.

**Container - Freight - Development – Report:** Contrary to the all-time highs that we see on the Sisal markets these days, container-freight rates in some trades have come down since the beginning of the year, also influenced by impact of fierce competition between the shipping companies of Maersk Line and MSC.

The situation in Brazil is currently favourable for buyers, as further competition emerged in Salvador - Port. Until today, freight rates to particular destinations in the Far-East region dropped nearly by 30% compared with February 2011!

One reason for this significant fall of container freight rates in the Brazilian trade besides the new competition is the fact that the volume of Brazilian imports from the Far-East is far in excess to the volume of Brazilian exports to the latter region. Thus shipping lines need the availability of containers in Asia and are therefore trying to lure shippers with very low freight-rates for those destinations, because for the shipping lines this is still better than sending empty containers back to Far-East.

Ports attracting less traffic cannot benefit from declining freight-rates likewise. Destinations concerned are for example Middle East and Africa. Reason is on the one hand the lower demand for freight space and on the other hand the actually higher costs of transportation, due to the necessity to tranship the containers several times until the final destinations are reached.



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Compared with other destinations around the world, the decreasing freight costs are contributing the CFR/CIF / CIP Sisal - price increase being less for some particular destinations in East-Asia. This freight-cost development is creating again another economical advantage in addition to the already considerably low production costs in that region.

The situation concerning container freight rates for shipments from East Africa to Europe is more stable in general. Thus, the possibility of considerable decreases in the region of 30 % is not yet within sight. The container freight rates concerning the trade between African ports and Far East destinations came under renewed pressure and have reached new low levels for the benefit of Asian buyers of East African Sisal. Container freight rates for other destinations are slowly starting to ease too. Shipping lines are inclined to re-negotiate container freight rates now and then with adjustment to lower levels.

The difference between container freight rates applying to the main destinations in East-Asia and some destinations for example in North-Africa or West-Africa however is dramatic! Current container freight rates are sometimes more than 9 times dearer than those asked for shipments to destinations in Asia! Not to mention the surcharges that shipping lines are demanding in order to be able to increase their prices without prior notice.

The situation for shipments from Madagascar is the same sine some years. Since vessels of only one shipping line are calling at the port of Ehoala the freight rates applying for shipments from that port are obviously very profitable for the corresponding carrier. Purely for freight reasons Madagascar sisal exporters now as before are placed in a significantly less advantageous position compared with sisal exporters in Kenya and Tanzania using the ports of Mombasa and Tanga who are benefitting from much lower container freight rates and higher frequency of sailings.

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