

# Growing appetite for ethanol puts strain on Brazil's cane millers

After years out of favour, the country's biofuel producers face a surge in demand from home and abroad, writes Elizabeth Johnson

'If you look at the ethanol landscape, the US and Brazil are like Kuwait and Saudi Arabia'

Brazilian sugar cane producers dream of the day when their cane-based ethanol will fuel cars from Stockholm to Tokyo. But for that to happen, they must prove they can produce enough of the biofuel for buyers to rely on year-round.

The country's biofuels programme is among the most advanced in the world. Nearly 30 years ago, the military dictatorship launched a pro-ethanol push, offering subsidies for cane mills and price controls in an effort to reduce dependence on crude imports following the 1970s oil crisis.

The programme was a resounding success. Local carmakers designed ethanol-fuelled cars, and nearly all new automobiles ran exclusively on the clean fuel throughout the 1980s.

However, when world sugar prices spiked in 1989, Brazilian mills opted to shift production back to sugar – the other main product of cane – and the price of ethanol was capped by the government. The move left many filling stations dry, souring people on ethanol for a decade.

When Brazil's new democratic government ended price controls and dismantled subsidies for the fuel, mills were forced to become highly efficient. Most

depended on distilling operations when sugar prices sagged – although they were also helped by government mandates that all gasoline at the pump contain at least 20 to 25 per cent ethanol.

But ethanol faced additional problems. Motorists considered pure-ethanol cars sluggish dinosaurs, and by the first years of the new millennium, sales had fallen to just 1 per cent of total new vehicle sales.

When oil prices soared again earlier this decade, Brazil's motor industry decided to fight the old stereotypes, introducing "flex-fuel" cars, which boast better performance thanks to engine technology that constantly adjusts to a mix of ethanol and gasoline. Since their launch in 2004, the cars have become an enormous success, accounting for 71 per cent of all new car sales in December, up from 24 per cent a year earlier.

Waldemar Guilherme, a São Paulo taxi driver who bought his flex-fuel GM Meriva in 2004, had bad experiences with ethanol-fuelled cars in the past but has been pleased with the new models. "It runs like a gasoline car, but I've only used ethanol since I bought it," Mr Guilherme said.

Meanwhile, the flex-fuel cars have raised fresh con-

cerns about ethanol supplies. Increased demand has lifted the price per litre by 25 per cent since the cane harvest began winding down a month ago.

Industry analysts say there will be enough ethanol to supply the market – but only just enough.

The country will have about 250m litres of ethanol stocks when the seasonal cane harvest resumes in May. That is enough to supply the domestic market for about one week, according to the São Paulo Sugar Producer's Association (Unica).

The government has tried to strong-arm the mills into containing prices, in what analysts say is a populist ploy in an election year. São Paulo's BM&F commodities and futures exchange said recently it would suspend its ethanol futures contract if the government insisted on controlling prices.

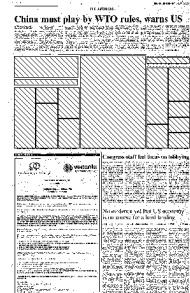
Potential foreign buyers of Brazilian ethanol, such as Japan, South Korea and Taiwan, will all be watching supplies closely as they decide whether to move ahead with their own ethanol fuel additive programmes, which would rely on ethanol imports. "Markets such as Japan are very sensitive to supply issues and the current situation is quite problematic for opening new markets," said Christoph Berg, an ethanol analyst from FO Licht.

In response to growing market demand, Brazilian

millers are investing heavily to increase sugar cane production and erect new mills. Their goal is to double ethanol production to 34bn litres per year by 2013. "If there's a plan in place, Brazil will increase production. It has the land and the capital to meet demand, but it won't happen overnight," said Fabrizio Vichichi, the executive vice-president of brokerage firm Nobel Americas.

The country is actively seeking to promote ethanol programmes in Thailand, India and central America, but global clients worry that it will be impossible to guarantee supply unless more countries begin producing significant volumes of ethanol for export. "Ethanol will become a global commodity, but it will take time," said C. Harry Falk, the president and chief executive of the New York Board of Trade. He estimates a real global marketplace will take three to four years to emerge.

The obvious candidate to



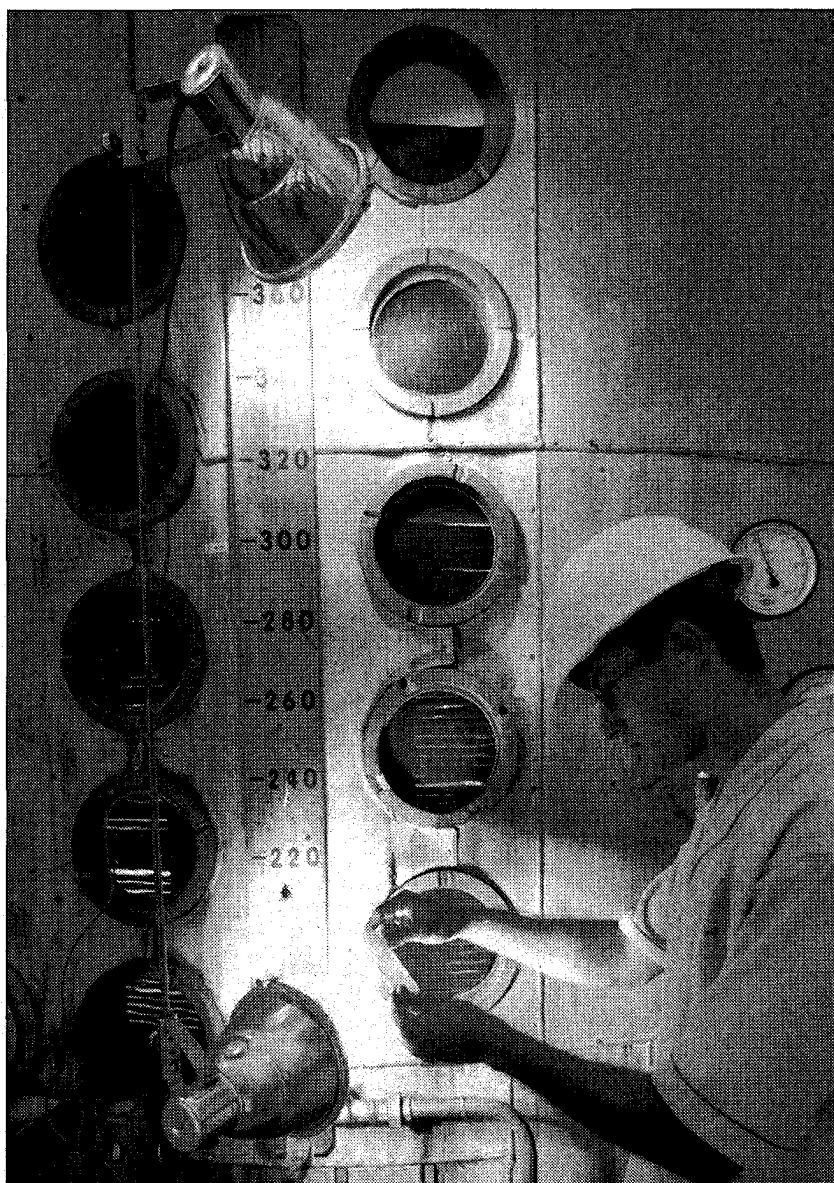
team up with Brazil would be the US, which has become the world's number-two ethanol producer by offering subsidies to farmers in the Midwest who make corn-based fuel. It does not yet export ethanol.

"If you look at the ethanol

landscape worldwide, the US and Brazil are like Kuwait and Saudi Arabia," said Mr Vichichi. However, a partnership would entail some tough decisions for Brazil, where producers have already expressed concerns about subsidies granted to

north American producers.

"US ethanol producers get roughly \$1.20 per gallon in incentives ... if they export under these conditions, it would give them a tremendously unfair advantage," said Fernando Moreira Ribeiro, a Unica executive.



Workers at a mill in Sertãozinho, near São Paulo. Brazil plans to double ethanol output by 2013. Reuters