

**February 15, 2018 | Industry Research**

**Government hikes sugar MSP to Rs.31/kg from Rs.29/kg**

On 14<sup>th</sup> February 2019, the government raised the Minimum Support Price (MSP) of sugar to Rs.31 per kg from Rs.29 per kg that was fixed in June 2018. The MSP is primarily hiked to provide more liquidity to sugar mills so that they are able to pay sugarcane arrears to cane farmers.

The industry has been looking forward to this demand for some time now and raising MSP by the government will elevate the sugar prices which will bring some relief to the sugar industry that is burdened with huge cane arrears. An increase in sugarcane prices amid muted sugar prices is the prime reason for the industry's cane arrears.

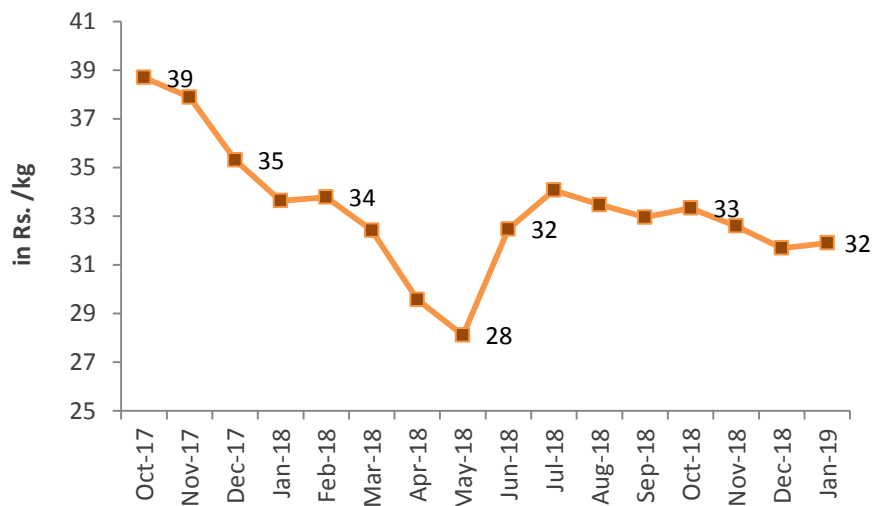
**Contact:**

**Madan Sabnavis**  
Chief Economist  
madan.sabnavis@careratings.com  
91-022-6754 3489

**Bhagyashree C. Bhati**  
Research Analyst  
bhagyashree.bhati@careratings.com  
91-022-6754 3490

**Mradul Mishra (Media Contact)**  
mradul.mishra@careratings.com  
91-22-6754 3515

**Chart 1: Trend in average wholesale sugar prices in India (Rs. /kg)**



Source: CMIE

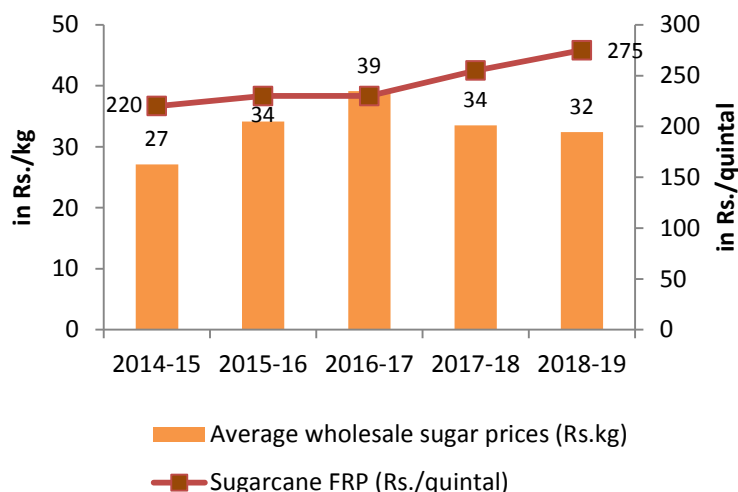
The average sugar prices in India have been on a declining trend since the start of the sugar season October 2017-September 2018 on account of a surge in sugar production during the year. Sugar production in India jumped by 57% on a y-o-y basis to 32.5 million tonnes in 2017-18.

The prices that averaged at Rs.39 per kg in October 2017 fell to the lowest level of Rs.28 per kg in May 2018. To prevent the downward trend in prices, the government fixed the MSP for sugar at Rs.29 per kg on 6<sup>th</sup> June 2018. Resultantly, the prices increased and averaged at Rs.32 per kg in the month of June 2018 and grew further to Rs.34 per kg in July 2018. The prices however fell in the next month and remained in the range of Rs.32-Rs.33 per kg during August 2018-January 2019. An expected surplus sugar output for the season 2018-19 kept the prices range bound. ISMA estimates sugar output to decline by 5.5% to 30.7 million tonnes while consumption is estimated to be around 26 million tonnes in 2018-19.

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The prices remained range bound amid higher cane prices thus resulting in huge sugarcane arrears. Therefore in order to bring liquidity to sugarcane mills and reduce cane arrears, the government announced a hike in MSP. **Post this announcement, we expect the wholesales sugar prices to increase to Rs.34-Rs.36 per kg in the coming months.**

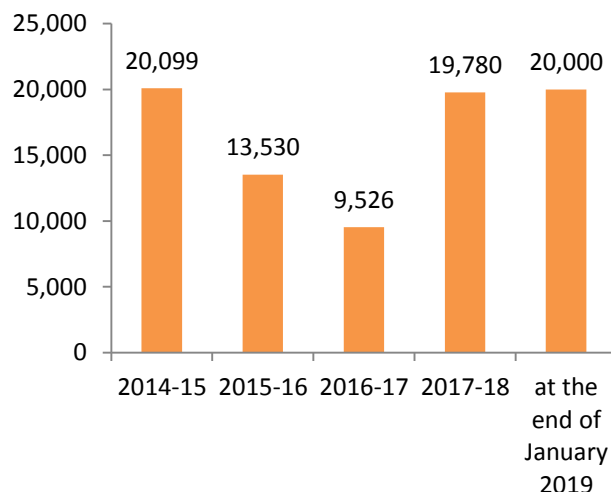
**Chart 2: Trend in sugar prices and sugarcane FRP**



Source: CMIE

Note: Sugar prices for 2018-19 are average prices for the period October 2018-January 2019

**Chart 3: All-India sugarcane price dues (in Rs. crore)**



Source: ISMA

Note: Cane arrears at the end of January 2019 are estimates provided by ISMA

From Chart 2, it can be observed that while sugarcane prices were higher for sugar season 2017-18 sugar prices declined to Rs.34 per kg on a y-o-y basis. The same trend continued in the current season as well. While the sugar prices continued the downward trend and averaged lower by 11% y-o-y to Rs.32 per kg during the period October 2018-January 2019, sugarcane prices were higher at Rs.275 per quintal. Thus a mismatch in sugar and sugarcane prices is the main reason for the rising sugarcane arrears in the country and with this trend continuing, the cane arrears have reached the levels of about Rs.20,000 crore at the end of January 2019.

**Cost of sugar production considering FRP**

As per a sample of 43 sugar companies for 2017-18, the raw materials cost accounted for around 85% of the total expenses, primary raw material here being sugarcane. Considering this, Table 1 is prepared which provides an idea on sugar production cost.

**Table 1: Cost of sugar production considering FRP**

	(in Rs./tonne)	Total cost of cane for producing one tonne of sugar (in Rs.)	Sugar price (in Rs./tonne) considering raw material cost at 85% of total expenses	Cost of producing sugar (in Rs./kg)
<b>2018-19</b>	2,750	27,500	32,352.9	32.4

It can be observed from the above table that the cost of production of sugar that comes up at Rs.32.4 per kg is more than the Rs.31 per kg MSP of sugar fixed by the government. Thus, the MSP will not be sufficient to cover the cost of sugar production.

**Nevertheless if we suppose that the hike of Rs.2 per kg goes towards payment of cane arrears then it can bring down the cane dues by about Rs.3,400 crore for the sugar year 2018-19.** This amount is based on the assumption that India would consume about 17 million tonnes of sugar during the eight months (February-September 2018) of the ongoing sugar year. Sugar consumption for the entire 2018-19 season is expected to be at around 26 million tonnes.

#### Concluding remarks

- The announcement will bring some relief to the sugar industry as this move is expected to elevate the sugar prices and **we expect the wholesale sugar prices to be in the range of Rs.34-Rs.36 per kg in the coming months.**
- **An increase in MSP of sugar can bring down the cane arrears by about Rs.3,400 crore for the sugar season 2018-19** assuming that the hike of Rs.2 per kg goes towards the payment of cane arrears.