Global Supply & Demand Outlook for Vegoils

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At **POTS CHINA**
Hosted by **Malaysian Palm Oil Council & Malaysian Palm Oil Board**
In SHANGHAI at Kerry Hotel Pudong
On 15 September 2014

Ladies and Gentlemen

I am delighted to be in CHINA once again this year. Participation in a **Palm Oil Trade Fair and Seminar** is always an enormous pleasure. Participation in POTS CHINA, hosted by the **Malaysian Palm Oil Council and the Malaysian Palm Oil Board, is twice the pleasure.** I am honoured to be invited to present my views in the august presence of **His Excellency YB Datuk Amar Douglas Uggah Embas, the Minister of Plantation Industries and Commodities, my old friend Tan Sri Dr Yusof Basiron and several very eminent dignitaries from China**

Much has happened since my last paper in Mumbai at POTS – INDIA on 26 June this year. A recent statement by me that in bear markets, commodity prices tend to gravitate towards the cost of production has created a stir. So let me get straight to explaining this point.

Background

The price forecasts I made at the **Price Outlook Conference in Kuala Lumpur on 5 March 2014 were quickly over-taken by events and had to be abandoned.** I have laid blame on the non-performance of bio diesel consumption targets by Indonesia and the non-appearance of a strong El Nino this year.

On 26 June I forecast that CPO prices would trade in a band from 2300 to 2500 Ringgits for the next several weeks, given normal weather. This forecast too has been overtaken by events and has been broken on the downside. CPO futures traded at 1914 Ringgits on the Bursa Malaysia on 2 September.

Malaysia has since exempted crude palm oil from Export Duty and this measure has given a bounce of about 200 Ringgits to the market.

Why did palm oil futures drop to 1914 Ringgits ?

I believe the USDA Report of 30 June was a turning point in the market. After consistently under-estimating US crops for the last 2 years and consistently under-reporting US stocks, the USDA appears to have turned over a new leaf. Their acreage and yield estimates of 30 June pushed markets into a bearish mode. The USDA appeared to confirm what many of us had been warning about – that US corn and soybean crops were poised to be the biggest in history and that end – year stocks were going to be burdensome.

Growing weather in USA in July and August has been almost ideal. Recent anecdotal reports of yields have been mind-blowing.

Side by side, conditions in the former CIS in the Sunflower seed belt were almost ideal. The weakness of the Ukrainian currency was another bearish input.

In the palm belt, the dreaded El Nino failed to emerge. Even the dry patch of June soon faded away and fresh rains came well in time. CPO production in July and in August took the market by surprise as production and stocks far exceeded expectation.
We must remember that most plantations had been sitting pretty in the knowledge that an El Nino was going to emerge with its bullish impact on prices. So plantations were very under- sold. Most had been selling hand to mouth, waiting for higher prices. When reality sank in that the El Nino would gradually emerge in a mild form only towards Q4, we saw a panic amongst producers

Palm exports have also been soft particularly on account of lower shipment to China. I do not need to go into local problems of palm and veg oil imports into China except to say that most participants did not anticipate these sharply lower exports.

There are a few other bearish factors also but these continue to be around and therefore I shall discuss them a bit later when I talk about Price Outlook.

PRODUCTION

Palm oil: The performance of oil palms in 2014 despite a 6 week dry patch in February and March 2014 and then another dry patch in June gives rise to one very important conclusion. The new planting material used since 2006-7 is significantly better and these young palms are much better able to tolerate dry conditions.

This is a cause of some celebration and we must congratulate the companies and organisations that have developed these new planting materials. We all know that new corn and soybean seeds are more drought and pest resistant and give rising yields under difficult conditions year after year. This is technology and human ingenuity at work. I have always showered praise on the plantation sector in South East Asia and the remarkable progress in the science of plantation management, tissue culture and cloning. No other region in the world can match this part of Asia in terms of human ingenuity and **t**echnology in oil palm. In a peculiar way, the plantation industry here has become a victim of its own success.

The market and that includes all of us, failed to spot the performance of these young palms. My own estimate of Malaysian CPO production for 2014 was at the higher end at 19.7 to 19.9 million tonnes. I believe I shall have to revise this estimate upwards and hope to release a new estimate at my next paper at **GLOBOIL India in Mumbai on 28 September**. Similarly I believe Indonesian plantations are playing out of their socks and their production is better than forecast.

This development of more resilient and productive palms coincides with the rise in emphasis on **Sustainability.** I have always believed, and said so frequently, that we should never be afraid of technology and of doing the Right Thing. When we set the bar higher, we encourage our professionals to aim higher and to achieve better. Could it just be that the emphasis on Sustainability, on doing the Right Thing, adopting sustainable practices has given us this enormous benefit of more resilient and more productive palms? I firmly believe this to be the case. I believe the **Round Table on Sustainable Palm Oil** and the legions of professionals in the palm plantation sector who have worked towards it can take satisfaction from this development. The rise in productivity and in more resilient performance coincides quite dramatically with the rise in sustainable practices. As a nation, Malaysia deserves kudos for its contribution. Malaysia's great palm oil companies like Sime Darby, Felda, Wilmar, United Plantations, IOI and KLK are in the forefront. They cannot however rest on their laurels. The Indonesian pack led by Golden Agri and Musih Mas is giving them a run for their money. And may this healthy competition always flourish.

I believe palm oil stocks will keep rising and will peak in December this year.

During the first 8 months of 2014, Malaysian production was higher than 2013 by almost 991,000 tonnes. On the other hand, exports were Down by almost 777,000 tonnes.

	Jan – Aug 2013	Jan – Aug 2014	Difference
Production	11.769 mln mt	12.760 mln mt	+ 991,000 mt
Exports	11.767 mln mt	10.990 mln mt	-777 ,000 mt

These figures put into perspective the problem for the palm oil market and the reason why prices have declined so much.

Production prospects for other Oilseeds and Oils

I am not going to dwell too much on the current soybean crop which is due to be harvested in USA. However I am going to flag 3 points of concern to the market:

Farmers in Brazil and later in Argentina are likely to switch to soybeans from corn this year Argentina is likely to have to devalue its currency and that can lead to a bearish shadow over the market

If a mild El Nino develops in South East Asia from October onwards, it will lead to very good rainfall in Brazil and Argentina at about the same time. There is a very strong correlation between dry weather in South East Asia and good rainfall in Brazil and Argentina. So on top of a huge US soybean crop, we are likely to face big crops from Brazil and Argentina with Brazilian beans likely to be available for export as early as January 2015.

Most other oilseeds (except rapeseed in Australia) are grown in the Northern Hemisphere during its Spring and Summer. Hence these crops are too far forward to impact prices for the remaining months of 2014 and early 2015. This means Price Outlook for the rest of 2014 and early 2015 rests firmly on Palm, North American soybeans, Canola and South American soybeans.

INDIA

The late revival of the monsoon rains in India has been a huge blessing. We now anticipate that the Indian soybean crop this year may even exceed that of last year. The big loss will be in the Groundnut crop but that is no longer relevant in terms of edible oil.

Indian imports are now running at a pace we have not seen at any time in history. This is not so much Demand Pull as Supply Push. Many palm oil vessels that were meant for China have been diverted during August to India. As a result, **imports during August reached an astronomical figure of 1.34 million tonnes.** Indian ports are congested with veg oil ships waiting to berth. September imports will also exceed a million tonnes. After that it remains to be seen if India will have room to take in heavier imports.

I have some comments on the subject of import taxes on veg oils in India. The recent drop in prices has made life extremely difficult for India's oilseed farmers. We must remember that Indian farmers are poor due to the small size of Indian farms and their low productivity. Current oilseed prices in India make oilseed planting uneconomic. Therefore the industry in India is urging India's new dynamic government, to come to the rescue of India's beleaguered oilseed farmers. An import duty of 10% on all crude oils and 25% on all refined oils has been suggested. If such steps are not taken, there will be extreme distress amongst Indian oilseed farmers when they bring their harvested crop to market in the next 6 weeks.

As I had forecast in my June paper, India did impose Safeguard Import duty of 20% on Oleochemicals which are affected adversely by Indonesia's Inverted Export Tax structure.

CHINA

Imports of palm oil into China are likely to remain thin for the next 3 months at least while large high priced stocks are consumed. We must also remember the huge Reserve Stock of almost 5 million tonnes of Rapeseed oil held by the State Reserve. A large proportion of this oil now desperately needs to be rotated or consumed before it reaches the point of no return. I understand some bold decisions are being taken to liquidate this stock in gradual instalments over 3 to 5 years. At the very least, it will mean 750,000 tonnes of old oil being released into the domestic market every year. I believe this is going to be a bearish factor, particularly for Rapeseed oil. It has been over-looked by the market.

I have previously advocated that China should temporarily halt completely any imports of rape and canola seed so as to allow release of this oil. The rapeseed market worldwide has been living a false life based on this huge stock held by China. In short China has subsidised and supported the entire world in terms of rapeseed and rape oil prices. It is not in China's interests to continue to do so. That situation needs to change.

WORLD DEMAND

The one big silver lining on the Demand side is the decision of the Brazilian Government to raise the mandate for bio diesel from 6 to 7 % from 1 November 2014. Soya bio diesel exports from Argentina are at a new high and have captured most of the bio diesel markets in Africa. This market once used to belong to palm bio diesel. China has emerged as a strong importer of palm bio diesel but winter cold weather will now intervene and these imports will thin out until April next year. For most other markets, bio diesel production is a problem due to capacity constraints and climate. POGO spreads are currently at extremely attractive levels but it has not led to a huge expansion in demand. As a friend quipped recently "Bio diesel is maxed out and cannot come to the rescue of prices."

Though Europe will produce almost the same volume of bio diesel as last year, the consumption of veg oils will reduce somewhat due to greater availability and use of animal fats and of Used Cooking Oils.

World Food Demand appears to have expanded by about 3.5 million tonnes. World bio diesel demand grew by only 1.7 million tonnes. We are yet to see the US EPA display its hand on bio diesel in USA.

GLOBAL INCREMENTAL SUPPLY & DEMAND

We can now summarise the **Global Incremental S&Ds** as follows

000 tonnes	**Oct 12 to Sept 13**	**Oct 13 to Sept 14**
Soya oil	+ 100	+ 1, 800
Rape oil	+ 500	+ 400
Sun oil	- 1,200	+ 1,600
Gn & Cttn oil	- 250	--------
Palm oil	+ 1,500	+ 3,500
Lauric oils	+ 450	+ 300
Total Supply Increase	**+ 1,100**	**+ 7,600**
Total Demand Increase	**+ 4,500**	**+ 5,200**

PRICE OUTLOOK- Assumptions

I have assumed Brent crude oil will trade in range US$ 95 and 110 per barrel. **Energy prices are critical to bio diesel demand.**

PRICE OUTLOOK

As I said in my June paper, palm desperately needs to regain its competitiveness. **Strange as it may seem, palm today is less competitive than it was last year as well as in June this year**. Its discount to soya oil FOB Argentina and to sun oil FOB Black Sea has been narrowing. Rapeseed oil is also becoming competitive and in India we have Europe trying to export Rapeseed oil for the first time in many years for October shipment.

The competitive position of palm on forward months like Jan-Feb -March or April-May- June is even worse than it is for Q4 2014. The palm market has a Carry while other oils are flat.

In Q4 2008 we were facing a similar situation with regard to Supply, Demand and Price. **At that time Palm rapidly made itself competitive and exported its way out of a crisis** as Malaysian stocks peaked at 2.238 million in December 2008.

Let us look at the price discount for RBD Olein as compared with soya oil and sun oil in the 3 months immediately preceding this big export PUSH of December 2008. These figures are taken from **Oil World.**

2008	Nov $	Oct $	Sept $
RBD Olein fob	521	577	774
Soya oil fob Arg	697	773	983
Sun oil fob Black Sea	732	822	1010

That means RBD Olein must open up a discount to soya oil on a fob-to-fob value much larger than at present. Current discount is about US$ 80 on the nearby and only US$ 55 for JFM and as little as $ 35 on AMJ. I shall say no more but I hope palm oil producers and exporters take notice of where they stand vis-à-vis the competition.

I congratulate the Malaysian government for abolishing the Export Duty on CPO. However I was aghast when BMD futures soared on the news and took away all competitiveness that was created by that abolition. Palm bulls made a huge mistake for short term gain.

I believe BMD futures on the 3rd month should trade for the next several weeks towards the cost of production and strive to regain competitiveness. In the first instance that translates to a BMD 3rd month price of 1900 Ringgits. It is almost impossible to forecast a bottom at this stage of the production cycle. We need to study the production performance in the peak month of October and also look at the outturn of the US soya crop and the outlook and progress of Brazilian plantings.

Soya oil price: I believe soya oil FOB Argentina will stabilise around current levels even if soya oil futures rise on Oil-Meal spreading. We are likely to see a level of US$ 730 to 750 FOB Oct-Nov-Dec.

Sunflower oil: I believe sun oil has been the most dynamic oil this year and has adjusted its price to win new demand as supply has expanded. The discount of sun oil to soya oil has now eroded and sun oil will move to a small premium of US 30 to soya oil.

Coconut oil and Palm Kernel oil: My prediction of a swift decline in the price of both oils has come good so far but not by enough. Supply of CPKO is very strong and stocks are expanding. As at the end of August, Malaysian stocks of PKO are the highest since June 2013. **As in 2013, I believe CPKO has no option but to decline to the level of CPO on a CIF Rotterdam basis and make itself workable for inclusion in bio diesel feedstock.** Otherwise CPKO stocks will be simply too heavy. Coconut oil can trade at a premium of US$ 120 to the price of CPO and CPKO in Rotterdam.

What about Planation Equities

I am often asked these days if Palm Plantation and Processing company equities should be bought. My answer is a resounding YES. You invest in plantations when palm oil prices are low. I prefer processing companies which manufacture Speciality fats, Oleochemicals, Bio Diesel and own Consumer brands. Upstream companies will benefit when the price cycle turns. However, this is a very good time to invest in this sector.

Conclusion

We are undoubtedly in a bear market. However, producers are still very much in the money and I do not foresee prices going below cost of production. The industry will have to work hard to keep up and to secure new efficiency gains. The new wonderful planting materials will ensure long term profitability. And we must never forget the old time tested adage – **"Within this Bear Market are planted the seeds of the Next Bull Market".**

My faith and confidence in our industry remains strong and that is why I believe we shall come through this test with our heads held high and our wallets secure.

So once again, my compliments to MPOB and MPOC – two of the finest organisations I have had had the privilege to work with. And my thanks to all traders in China who have made the Dalian Commodity Exchange the world's most active market for vegetable oil.

Good Luck and God Bless