Palm & Lauric Oil Price Outlook 2014

With special regard to India

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Ladies and Gentlemen

It is a pleasure and a privilege to be here at Bursa Malaysia's flagship Price Outlook conference. My first ever public speech on Price Outlook was here in Kuala Lumpur in 1997 and I have been here each year since.

I am also very grateful to BMD's CEO Mr Chong Kim Seng for coming to Mumbai in December 2013 to grace the inauguration of the CPO futures contract launched by NCDEX. Cooperation between Exchanges is excellent for our industry. Above all, I am delighted to welcome our Managing Director Mr Nadir Godrej who is here with us. At Godrej we take our commodity pricing very seriously.

Background

I have to acknowledge at the outset that my bearish forecast for CPO prices, made at this forum last year, did not come true. The reason was Bio Diesel. As has been said by me previously, the 3 most important factors in palm oil pricing during 2013 were **Bio Diesel, Bio Diesel and Bio Diesel**.

Later in the year, in papers delivered at **CIOC in Guangzhou** and at **GAPKI in Bandung,** I revised my forecast. These forecasts were spot on and so I come to this conference feeling much better.

We meet today in rather exciting circumstances. There is talk of a developing El Nino. We have had 5 weeks of dry weather here in the palm belt. Above all, the Indonesian Bio Diesel mandate and its aftermath and other emerging Bio diesel markets will continue to excite us.

The year 2013 was also marked by production under-performance. The biological Low Cycle turned out to be longer and deeper than most of us had forecast. Instead of lasting just 8 months and ending in September, it has stretched much longer and is now likely to end in May or June 2014. The market waited for production to improve but finally threw in the towel in mid- October. We saw BMD futures bottom out at 2167 on 29 July 2013. That was also the time when Palm Oil-Gas Oil spreads were at high levels and made Discretionary Blending possible. Prices recovered and were at a level of almost 2400 Ringgits when in mid- September, Indonesia announced its masterstroke to mandate 10% blending of palm methyl ester in all transport diesel. In theory this would take away almost 3 million tonnes of supply

This made me change my outlook and I forecast that BMD futures would trade in a range between 2400 and 2600 with a possibility of climbing up to 2800. Later I further revised that forecast to a range of between 2600 and 2900 with a possibility of touching 3000 by March 2014. I also suggested a trade of buying JFM 2014 RBD Olein paper and selling JAS or OND against it.

CAUTION

This is only the third time in the last 10 years that vegetable oil prices have traded BELOW the price of mineral oil for a substantial period. The norm is for veg oil prices to trade above or considerably above mineral oil prices. The Government of Indonesia has taken a considerable gamble on its 10% palm bio diesel mandate. The test will come when palm prices rise considerably above the price of mineral oil. They will have to subsidise the producers of palm bio diesel. The producers who sell hundreds of thousands of tonnes of palm bio diesel under long term contracts linked to Singapore Gas Oil will need to hedge themselves fully and this action itself can exert a powerful bullish influence on palm prices – as we have been witnessing recently.

Let there be no doubt. The Indonesian Mandate is a powerful bullish factor and we are just beginning to see its impact. The Indonesian Government has let the Genie out of the bottle and there will be consequences to follow.

The MACROS

I want to make some remarks on the macro economy.

The biggest single factor to impact commodity prices as well as Equities was the phenomenon called Quantitative Easing or QE. In the dark days of 2008, a Governor of the Federal Reserve made a joke referring to the Balance Sheets of certain banks:

“Not everything on the Left is right and nothing on the Right is left ”.

The words belonged to Janet Yellen and she was referring to Assets of questionable value and the gaping holes in Capital. We must appreciate the strong steps taken by the US Federal Reserve to rescue the world from the abyss of a Depression. We have had rising and record Equity Markets and strong Commodity prices.

One might even say, using a palm oil analogy that QE was the PME (Bio diesel) of the World Economy !

We have just entered what is called the Tapering Phase. The conventional wisdom was that Interest Rates on US Government Debt would rise as Tapering began. In reality, the opposite has happened. One reason could be that the liquidity of about $10 Billion lost each month as a result of the Taper, has been made up by the repatriation of Dollar funds from Emerging Markets. It remains to be seen how interest rates behave once the Taper begins to bite and QE is completely eliminated by the end of this calendar year.

Around that time I believe all asset prices will face their biggest challenge. A hedgie friend of mine told me when QE 3 was announced: “We just had to have QE 3 because only then can we go to QE 4 !” My friend was speaking only half in jest. It remains to be seen how markets react to a world without QE and how interest rates behave. I believe this will be a very challenging moment in history and a major Financial Moment or Crisis may not be inconceivable.

Having warned of such a danger I now proceed to the annual Oscars.

The Oscars

Last year I heaped praise on the **Malaysian Palm Oil Board** for the accurate and timely reporting of Malaysian statistics. I am pleased to say they have continued their sterling good work during the year. I also compliment the **MPOC** on its remarkable promotional work.

During 2013 we saw the RSPO expand its work and gain greater recognition along with a new Chairman. Several palm oil companies have distinguished themselves in flying the banner of Sustainability and in giving our industry a good name.

I must congratulate the **Sinar Mas** group of Indonesia and in particular **Golden Agri Resources** on their strong contribution to sustainability. Amongst other things they have also greatly professionalised their operations and have a new team in harness. And the new team has made a great start. My congratulations to those concerned, many of whom are my close friends.

I cannot avoid complimenting my friends at Wilmar who have taken a strong stand on Sustainability and have proceeded courageously in the face of some criticism. They are doing the right thing and need to be encouraged. Ofcourse, the pioneer of Sustainability is a Malaysian company – United Plantations – where our distinguished Chairman Karl is the CEO.

However, the Oscar must go to the crop forecasting and the trading team at **Cargill South East Asia.** Their crop estimates were spot on and even better than my own. The palm and lauric team at Cargill SE Asia has a very distinguished record and the new team richly deserves our kudos. My heartiest congratulations to that team.

INDIA

We had a great monsoon season in 2013. Infact the rains in the soybean belt were too good and led to some crop losses. Overall Indian crops have done well in 2013. The Rape-Mustard crop to be harvested shortly is also doing very well. Yet it must be said that India is now heavily dependent on imports and its domestic production is not of much consequence.

The Indian Government continued its total indifference to the fortunes of the Refining industry. The Export Tax structures of Malaysia and Indonesia made life extremely difficult for Indian refiners. Recently the Indian Government finally raised the import duty on RBD Olein but even that is not enough to rescue the hapless Indian refiners.

Let us first look at India's production of vegetable oil.
(Oil year November to October)

INDIA's PRODUCTION

000 tonnes	**2013-14**	**2012-13**	**2011-12**	**2010-11**	**2009-10**
	Estimates	Actual	Actual	Actual	Actual
Soybean oil	1350	1580	1575	1600	1150
Cotton oil	1240	1140	1150	1050	1100
Gn oil	500	150	400	500	450
Sun oil	240	220	240	230	350
Rape oil	2300	2100	1770	2250	1700
Sesame oil	110	120	120	150	160
Coconut oil	350	400	400	400	400
RiceBranoil	900	850	800	720	700
Others	450	400	345	250	250
Total	**7440**	**6960**	**6800**	**7150**	**6260**

As in previous years, I am indebted to my friend **Govindbhai Patel of GGN Research and the Solvent Extractors Association** for their help in compiling Indian statistics.

During the last 12 months palm oil has become less competitive as against its soft oil rivals even in India

Let us now look at INDIA's CONSUMPTION

000tonnes	2013-14	2012-13	2011-12	2010-11	2009-10
	Estimates	Actual	Actual	Actual	Actual
Soybean oil	2900	2700	2600	2550	2700
Cotton oil	1200	1100	1150	1050	1050
Gn oil	500	150	400	500	450
Sun oil	1540	1200	1320	1000	950
Rape oil	2300	2100	1850	2250	1850
Sesame oil	110	120	120	150	160
Palm oil	7950	8370	7385	6750	6460
Laurics	650	740	600	600	650
RiceBranoil	900	850	800	720	700
Others	350	350	350	250	250
Total	**18400**	**17680**	**16575**	**15820**	**15220**
Pop.Mlns	1275	1260	1240	1220 *	1175
Per cap kg	**14.43**	**13.92**	**13.36**	**12.96**	**12.95**

We can now study INDIA's S&Ds 000 tonnes

India's S & D for	2013-14	2012-13	2011-12	2010-11
Opening Stock	1500	1650	1325	1430
Production	7440	6960	6800	7150
Imports	**11060**	**10670**	**10200**	**8665**
Consumption	18400	17680	16575	15820
Exports	100	100	100	100
Ending Stocks	1500	1500	1650	1325

INDIA's IMPORTS of Vegetable Oil

000 tonnes	2013-14	2012-13	2011-12	2010-11	2009-10
Soya	1550	1090	1080	1000	1660
Palm	7880	8240	7680	6665	6700
Sun	1330	980	1140	800	630
Laurics	300	340	200	200	250
Others		30	100		
Total	**11060**	**10670**	**10200**	**8665**	**9240**

India in the near future

I am constantly being asked what impact a Modi Government is likely to have on the Indian oils and oilseed scenario. I expect the government to move quickly to give some protection to India's refining industry. However, the major impact will be long term. Remember Mr Modi comes from Gujarat and knows the oilseed industry extremely well. We know that Gujarat state engineered the big growth in cotton production under his leadership. The growth came mainly through higher productivity from GM seeds, better irrigation and non-stop supply of electricity.

India's northern states today grow wheat which is in surplus and has to be exported. It is more than likely that over a 5 year period a dynamic government will create conditions (such as high Minimum Support Price) to enable a massive switch from wheat to rape-mustard seed. At last, the long term scenario for oilseed production in India could give us some hope.

GLOBAL SCENARIO

I shall discuss first the Supply Side for our most important oil - Palm

PALM: The Low Cycle that commenced from February 2013 has turned out to be much more severe than I had anticipated. It may end only in May 2014 and we could enter a new High Cycle in June 2014. However, all this has been rudely interrupted by the current dry spell. **If this dry spell prolongs or a new El Nino develops later this year, all forecasts of CPO production and price will have to be revised.**

On the premise that the current dry spell ends next week and we have good normal rains for the rest of this year, I estimate Malaysia will produce between 19.5 and 19.7 million tonnes of CPO in 2014.

Indonesia produced 28 million tonnes of CPO in 2012. As I have said previously at the Gapki conference in Bandung on 29 November, my estimate is that Indonesian production in 2013 was less than 2012 by half a million tonnes. From that base of 27.5 million, I am forecasting 2014 production to expand by only 3 million tonnes to 30.5 million. Most of the growth will come in the last quarter of 2014. Again I must caution you this may turn out to be an optimistic figure if the current dry weather does not end very soon.

Thailand is already suffering a drought. Central America will see very little growth too. **Overall for the oil year October 2013 to September 2014, we shall see world palm oil production growing by just 3 million tonnes or less.**

RAPESEED: The Canola crop has been very good but Canadian logistics are a problem. No solution is at hand in the near future as agri products compete with crude oil for rail transport.

Ukraine will continue to expand rapeseed cultivation. The India crop is in excess of 7.4 million tonnes this year. If weather conditions are normal, Europe should also have a good rapeseed crop.

China has done absolutely nothing about its large 4 million plus stock of old rapeseed oil. At some stage this oil will have to be given for re-processing or for conversion to bio diesel. This year as prices rise, the Chinese are unlikely to bite the bullet because they will be hoping for prices to rise so high as to give them an easy exit. With each passing day, the cost of this exit is getting dearer.

SUNFLOWER SEED: We have had great sun seed crops in Ukraine, Russia and in Europe in 2013. I had correctly forecast pressure from sun oil. However such pressure has been short-lived. Demand for sun oil has been excellent and there has been no need for producers to sell sun oil at a discount to soya oil. The current weakening of the Ukrainian currency will keep sun oil competitive. In the current Oil Year 13-14 we shall have an increase of about 1.6 million tonnes of sun oil.

In 2014 we shall have to pay attention to weather and rainfall in the sun seed belt. These parts of Russia and Ukraine are increasingly becoming prone to dry weather every alternate year.

Groundnut & Cottonseed: Production of cottonseed oil will be lower but ground nut oil will be higher mainly on account of India

SOYA: The price behaviour of soybeans and soya meal in early 2014 has been a big surprise for many of us. Clearly Chinese crushers have preferred the security of timely arrival of US beans rather than the delays and demurrage associated with Brazilian beans. Even more interesting has been the attitude of Argentine farmers.

During the last 12 months, soya oil has shed its premium over Palm Olein and now finally moved to a small discount on an FOB price level. Soya oil prices have also been saved from further erosion by the demand for soya bio diesel.

The reserved selling by Argentine farmers will be a feature of 2014. We cannot blame them. As a result, Argentine farmers have converted soybeans into a currency. One could say world demand for

soybeans stems from edible usage and from currency usage. It is likely that we shall end the crop year 13-14 with record stocks of soybeans but these stocks will exert very little pressure on price because they will not be available to the market. Pressure will only come when the 2014 US crop is made – probably by the end of August 2014.

Among the new factor to watch is the enhancement of the bio diesel mandate in Brazil and to a lesser extent in Argentina. The extension of the Blenders Credit in USA is also said to be likely sometime later this year, with retrospective effect to 1st January 2014. Once this happens, soya oil will begin to re-build its premium over Palm Olein.

An interesting question has been posed to me. Large swathes of China are very poor. As it is often said, China is really 2 countries – the prosperous coastal areas and the less prosperous and price sensitive rural areas. We have seen a huge appetite for soybeans in 2013 and early 2014 with beans at about $ 13 per bushel. What is likely to be China's appetite when soybean prices decline to $ 10 or $ 11 per bushel (as they are for new crop November 2014) ?

LAURIC OILS

As a result of the typhoon the supply of Coconut oil will fall. Exports of Coconut oil will fall by a lesser tonnage because Philippines will import more palm and release expensive CNO for export. The production of Palm Kernel oil will expand in line with the production of palm oil.

DEMAND SIDE

Food Demand: I am estimating world food demand to grow by 3.5 million tonnes mainly as a result of better growth prospects.

Bio diesel Demand: The Indonesian mandate can take up to 3.1 million tonnes of extra palm oil. I am estimating that in the Oil Year 13-14, Indonesia will only consume an extra 1 million tonnes of palm bio diesel. It will take time to sort out various teething problems. In 2014-15 Indonesia will consume another extra 1 million tonnes. US and European consumption of bio diesel will remain more or unchanged. Malaysia will however consume and export more. I also expect mandates in Brazil and Argentina to be expanded as also in several smaller countries.

Growth will also come from what is called Discretionary Blending at the margins. The Demand for this in places like Africa and even China can be as high as 200,000 tonnes per month – but most of this demand is opportunistic and depends on the price of fossil diesel. There is no concrete formula to calculate this demand because viability depends on various local factors such as tariffs etc. Overall my estimate is that unless vegetable oil prices rise too quickly or mineral oil prices fall too low, world demand for bio diesel will grow by at least 3 million tonnes in the oil year 13-14.

Hence total demand will expand by about 6.5 million tonnes

Incremental Demand v/s Incremental Supply

We can summarize **Global Incremental Supply & Demand** as follows

000 tonnes	**Oct 12 Sept 13**	**Oct 13 to Sept 14**
Soya oil	+ 100	+ 1,600
Rape oil	+ 500	+ 400
Sun oil	- 1,200	+ 1,600
Gn & Ctn oil	- 250	-----
Palm oil	+ 1,500	+ 3,000
Lauric oils	+ 350	+ 200
Total Increase	**+ 1,000**	**+ 6,800**
Total Demand	**+ 4.500**	**+ 6,500**

We can see that last year Incremental Supply was out-stripped by Incremental Demand. We saw that in the rapid depletion of palm oil stocks. Between Indonesia and Malaysia, stocks were depleted by over 2.5 million tonnes.

For 2013-14 we see Incremental S&Ds broadly in balance. However this balance is achieved towards the end of the year – in the period July to September when palm oil production recovers. Until July world vegetable oil stocks and particularly palm oil stocks will remain very tight.

PRICE OUTLOOK

I am making an assumption that Brent crude will trade during the year in a band between $ 100 and $ 110 per barrel. I believe a major investment bank has forecast that Brent will end 2014 at $ 100 per barrel

I am also assuming a relatively stable US Dollar.

Given the current dry weather and the possibility of an El Nino, I shall give a forecast under El Nino conditions and another under more normal conditions.

PRICE FORECASTS

PALM: Palm oil production is under-performing and stocks are tight. A lot of bio diesel business has already been locked in whilst Spreads were workable. Therefore the job of the market until June is to push demand away from palm. Palm does not need to buy demand by price discounts.

I believe CPO futures on the BMD need to quickly scale up to 3000 Ringgits so as to control demand and enable stocks in Malaysia and in Indonesia to be maintained at a workable level. Prices should not rise beyond 3000 unless climatic conditions change for the worse.

If the weather improves and rains come by next week, it will not alter the price outlook up to June 2014. The job of demand rationing needs to be done.

However if rains come as normal and the High Cycle kicks in from July onwards, prices can trade in a range between 2900 and 2600 from July until October.

In the event that an El Nino develops I believe CPO futures will cling to 3000 Ringgits beyond June. Production is likely to be affected from late 2014 onwards and we may be staring 3500 Ringgits. We shall kill all Discretionary bio diesel demand. Indonesia will find it very difficult to implement its bio diesel mandate. Bio diesel producers who have committed large volumes at current formula based pricing may find themselves in a very difficult situation.

At this point I want to highlight a new dynamic in the palm oil market

There is going to be a big expansion of bio diesel capacity in Indonesia in the near future. This capacity will require bio diesel producers to lock in palm oil prices at least one year in advance. Almost all of them will be plantation linked. Hence the availability of freely tradable palm oil will become somewhat restricted. It will also require much larger stocks to be maintained. Therefore, palm oil stocks will need to be much larger before they begin to exert any pressure on prices.

For these reasons I believe the Indonesian mandate is truly a Game Changer and will keep palm oil prices relatively high for a long time.

Is there likelihood of palm oil production surpassing expectations and of prices falling below 2400 Ringgits in the rest of 13-14?

There is a small likelihood of production surpassing expectation if rainfall is better than normal. If prices of Brent fall and production of world oilseeds is also as expected, palm oil prices can fall below 2400 but that possibility is no more than 30%.

Soya: Oil share has been depressed as a result of the buoyant demand for meal. I believe oil share is due for an improvement. I expect soya oil futures to climb gradually to 47 cents and for flat prices to trade in a range between $1000 and $1050 by the time we get to October 2014. If an El Nino develops, prices will need to go higher, possibly towards $1200 to $1300. Soya oil will lose a lot of bio diesel demand in that case.

I expect **Sunflower oil** to command a premium over soya oil from now onwards. The premium could be between $ 30 and 100 until August 2014. After that it will depend on new crops in Russia and Ukraine.

Rapeseed oil will remain level with soya oil until the new crop in Europe.

Coconut oil and Palm Kernel oil have already moved to very high levels. I believe CPKO is enjoying the expectation that so much new Oleochemical capacity is coming on stream that there will not be enough to go around. Again there is very little freely tradable CPKO because most new Olechems are plantation linked. Producers have become consumers. This is an unusual phenomenon that always leads to margin destruction and ultimate idle capacity. I believe new Oleochemical capacity will lead to shutting down of some old capacity and some new capacity may run only partially. The market for Oleochemicals is not going to expand exponentially. Therefore I believe CNO prices at current levels will be sustained due to lower production but CPKO price will need to move lower after July 2014 and narrow the premium over palm oil.

You may ask me which is the oil with the most bullish price outlook?

That distinction belongs to neither of the oils we have discussed at this conference.

The most bullish outlook belongs to Indian Castor oil where we have had a smaller crop and a lower carry-over. Demand for castor oil is virtually inelastic. After many years of poverty and exploitation (which is why production is declining), Indian castor seed farmers will see remunerative prices.

CONCLUSION

Many of us called a premature end to the commodity bull market. The lesson to be learnt is that we must never take Mother Nature for granted.

At the same time, there are problems of the Macro Economy which could very easily derail the oncoming bull market. It is not for nothing that Commodity Prices are said to resemble the politician who was described by Winston Churchill thus: “He has all the virtues I dislike, and none of the vices I admire!”

This year weather holds the key and I am going to speak more often than in the recent past, giving you my analysis at short intervals.

I thank you all for your attention. My next paper will be in Beijing on 21 March.

Good Luck and God Bless

(My thanks as usual to my friend Alex Wells, the Walking Matrix, for his help in crunching the numbers and to GGN Research for their database on India)