Global Scenario on Supply, Demand and Price Outlook for Vegetable Oils - 2014

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Ladies and Gentlemen

I am delighted to be participating in the **10th International Conference hosted by China Cereals & Oils Business Net.** The world economy appears to be in recovery mode and a lot is expected of China. Recent news points to the determination of the Government in China to re-balance the economy, moving it away from export led growth whilst at the same time, keeping up the momentum of expansion. Measures such as freeing up interest rates on savings and deposits and the trial with privately owned banks are steps in the right direction and fuel some excitement in my mind.

Recent data coming out of China on exports has been somewhat soft. No doubt there are seasonal reasons for this. However, we must be mindful of their impact of commodity prices. China will generally do well with lower prices of energy as well as of basic raw materials like iron ore and copper. China is also worried about food price inflation. Here we come to our subject of price outlook for oilseeds, oils, meal and grains.

Background

At the recent **Price Outlook Conference in Kuala Lumpur on 5 March 2014,** I presented 2 scenarios: First one without an El Nino developing later this year and the second with an El Nino developing.

I forecast that current fundamentals for palm oil are quite tight and that under both scenarios prices need to quickly rise to a level of 3000 Ringgits in order to ration demand and to maintain stocks at a workable level for the next several months.

If an El Nino begins to develop from June-July onwards, prices will remain at 3000 Ringgits even during the High Production months of July to October and later may have to rise to 3500 Ringgits.

If on the other hand, an El Nino does not develop, prices can begin to slide after June and will trade downwards in a range from 2900 to 2600 Ringgits for the rest of the year.

One caveat I had placed was that the current spell of dry weather needs to be lifted very soon.

As I write this paper, forecasts have emerged of better rainfall and a change in the dry pattern from the week beginning 17 March. It remains to be seen how these rains perform. On the other hand, there is increasing confirmation that an El Nino will develop from June-July onwards. It will affect rainfall in a vast area of Asia. The south-west monsoon in India is likely to be impacted too. This is therefore a powerful bullish factor which is likely to kick in about 3 months from now.

New Factors since the Price Outlook Conference

We are also staring at 2 new factors which are impacting commodities and currencies. First: the crisis in Ukraine and the threat of sanctions of some nature being imposed by the USA and the EU on Russia. Second: the soft data on foreign trade and on economic activity coming from major economies such as China.

It is difficult for any economist or analyst to make forecasts whilst these uncertainties remain. The Government in China has reiterated its commitment to growth at 7.5% and it has the tools to stimulate the economy. It is conceivable that if the Government so wishes, it will stimulate the economy by use of any of the large number of measures available to it.

The situation around the Ukrainian crisis is a bit more complicated. I shall therefore leave it open and let you follow developments on a day to day basis. I have no magic crystal ball to predict how events will unfold. However, my guess is that all concerned do not want to disrupt normal trade and to put at risk the economic recovery that we are all expecting.

Developments in the Vegetable Oil market

The Indonesia state oil company **Pertamina** has announced a new tender for 14-15 for supply of bio diesel. What this underlines is that for the Oil Year ending September 2014, the 10% mandate will only be partially serviced. My Kuala Lumpur estimate of extra palm bio diesel consumption in Indonesia of only 1 million tonnes appears to be accurate. On the other hand, recent news from Argentina and from Brazil is not so encouraging for bio diesel. Argentina has enforced an absurd price cap on local price of bio diesel. This means it is absolutely uneconomic for local manufacturers to supply soya bio diesel within Argentina. Their consumption is therefore struggling and the mandate will remain at least 50% unfulfilled. In Brazil there is no progress currently towards increasing the mandate. In USA there has been no progress since my last paper on the Blenders Credit.

Further, prices of Gas oil (diesel made from fossil fuel) have declined. Therefore discretionary blending is currently not viable.

It is too soon to revise my estimate of Incremental Bio Fuel demand but at some stage in the near future, it may become necessary to do so.

Food demand for palm oil has also been lagging behind in the last few weeks.

This is mainly due to the very narrow discount for palm against soya oil and sun oil. We have seen sun oil take a big chunk of demand from countries such as India, Egypt and Iraq. This has created less demand for soya oil and also impacted palm oil. Another factor has been the large increase in soybean crushing in China. This has led to higher production of soya oil from imported beans in China and consequently less need for importing soya oil from Argentina or Brazil. If China crushes 9 to 10 million tonnes of extra soybeans in the oil year 13-14, it will mean lower import of soya oil by about 1.6 to 1.8 million tonnes.

There is no other significant news in the market post the Price Outlook conference in Kuala Lumpur 2 weeks ago. Crude oil prices have generally held steady or declined slightly. The only difference has been in sentiment with global tensions at a higher level.

Imports by India and China

Palm has been losing market share in India. Its discount to soya oil has almost disappeared. Therefore India, the world's largest importer of vegetable oil will prefer soya and sun oils in 14-15. Here is my estimate of India's imports:

000 tonnes	**2013-14**	**2012-13**	**2011-12**
Soya	1,550	1,090	1,080
Palm	7,880	8,240	7,680
Sun	1,330	980	1,140
Laurics	300	340	200
Others		30	100
Total	**11,060**	**10,670**	**10,200**

Imports by China will be somewhat lower because China is crushing much more tonnage of oilseeds and producing its own oil. The new factor is the popularity in China of bio diesel. We have seen palm bio diesel imports and I wonder when and if soya bio diesel will also be imported. At the margin, bio diesel has a very good impact on reducing pollution.

Palm Price Outlook

The Malaysian Palm Oil Board's figures for February which were released on 10 March were more bullish than the market had expected. Total Malaysian palm oil stocks were draw down substantially from 1.93 million tonnes to just 1.65 million tonnes. Prices should have surged at these numbers. However, the market looked at the lower figure of 1-10 March exports and tempered its reaction. Subsequently, exports for 1-15 March have also be running at a lower pace.

The market fears that stock draw- down may have been temporary and that in March we may see a small replenishment of stocks. Traders have at last begun to realise that palm oil has lost a big chunk of demand as a result of the narrowing or dis-appearance of its discount to soya oil and to sun oil.

Looking at the figures of Malaysian palm oil production during January and February, do I need to revise my forecast for 2014 production? My earlier estimate was for Malaysia to produce 19.5 to 19.7 million tonnes and for Indonesia to produce 30.5 million tonnes. At this early stage I am not reducing these numbers but at some stage, possibly in June, I may be compelled to reduce these production estimates.

I believe current price levels of BMD CPO futures are about right and prices do not need to go lower. On the other hand, the market is awaiting new inputs on weather, rainfall and some pick- up in demand. Consumers have been eating into their own pipeline while they wait for lower prices. In India for example, total vegetable oil stocks have decline from almost 2 million tonnes to less than 1.2 million. We are now approaching very tight levels and India will need to step up April imports.

I still remain bullish over-all on palm prices and expect 3000 Ringgits to be reached in April once we have more confirmed news about lower future production due to current dryness and the onset of an El Nino.

SOYA

There has been a significant improvement in Brazilian logistics this year. Yet Chicago soybean futures held up much longer than most people expected.

The reason was that Chinese importers have preferred to go ahead with all their purchases of US beans and have chosen to cancel or divert Brazilian shipments mostly. This has helped US soybean futures to hold on to higher levels for much longer. However, from now it is likely that soybean futures will decline more on the nearby months as South American shipments increase.

The USDA Planting Intentions Report on 31 March is keenly anticipated.

Soya oil also needs to attract more edible demand. For example the line -up of vessels for March in South America is quite revealing. About 250,000 tonnes are lined up for India but after that there is not a single destination with any significant tonnage. South American exports of soya bio diesel also appear to be tapering off. It seems to me that soya oil is also suffering from a lack of brisk demand and prices may come under pressure. My forecast of Chicago bean oil at 47 cents and flat prices at US$ 1000 to 1050 made at POC in KL on 5 March may not verify for some time. It will take until October 2014 for that forecast to be realised.

In USA in 2012 as well as 2013 we had drought during the growing season between June and August. The question on everyone's lips is whether we are going to have a third drought in succession and if 2014 is going to resemble the Dust Bowl year of 1936? Weather in North America has been strange of late and we must keep a very careful watch on weather developments.

RAPESEED

It is quite remarkable how Rapeseed oil prices are almost the same level as soya oil prices in 2014. Rape oil is doing precisely the right thing by making itself competitive for inclusion in bio diesel as well as in edible use.

SUNSEED

We have had big sun seed crops in 2013 and consequently sunflower oil is competing with soya oil for market share. The weakness of the Ukrainian currency as well the Russian Rouble will keep sun seed and sun oil very competitive.

We also need to keep a watch on weather in the sun seed belt of Russia and Ukraine. This region has developed a history of drought every other year. We need to watch out for any adverse weather in this belt in 2014.

COCONUT OIL & PALM KERNEL OIL

Both Coconut oil and Palm Kernel oil have managed to curtail demand by the lofty levels of their price. We can see a slow- down in demand. The lower production of Coconut oil will under-pin CNO prices for some time but there is little justification for CPKO to remain at current lofty levels.

Incremental Demand

I am maintaining my earlier projection of an increase in world food demand by 3.5 million tonnes. Increase in bio fuel demand may be somewhat less than my earlier POC estimate of 3 million tonnes.

CHINA

China's appetite for soybeans has surprised many of us. Perhaps some of this was triggered by the strong demand for meal and the excellent crush margins enjoyed for most of 2013. Now with deterioration in crush margins, China's appetite for beans will moderate.

China still has a massive stock of old imported Rapeseed oil. Some say this stock is as high as 5 million tonnes. In the current year as prices are likely to be high, the State Reserve will be tempted to hold on to stocks in the hope of selling this oil at high prices without suffering loss. I am afraid this is an empty hope. The oil in storage is deteriorating and must be auctioned off as quickly as possible. I am surprised that China has imported so much rapeseed this year again.

I would like to repeat here what I said last year. China needs to make its agriculture profitable for its farmers. There are 2 ways of ensuring that – by guaranteeing high prices to farmers or by a system of direct payments to farmers. In the West there has been a move away from Guaranteeing High prices and towards providing Direct Payments to farmers. China may also have to consider such a move. It would lead to lower food prices in China and in many parts of the world. The lowering of food price inflation will also give other benefits like facilitating the lowering of domestic interest rates with its beneficial impact on overall economic activity.

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, 600
Rape oil	+ 500	+ 400
Sun oil	- 1,200	+ 1,600
Gn & Cttn oil	- 250	--------
Palm oil	+ 1,500	+ 3,000
Lauric oils	+ 450	+ 200
Total Supply Increase	**+ 1,100**	**+ 6,800**
Total Demand Increase	**+ 4,500**	**+ 6,500**

We can see that in 12-13, Demand was much bigger than Supply. That was balanced by a big draw-down in stocks. Palm oil stocks in Malaysia and Indonesia declined by almost 2.5 million tonnes. In 13-14, Demand and Supply are in much better balance. We must remember that Ramzan demand will be earlier than usual this year. Most of the increase in supply will come in the last quarter of 13-14. So we can see tight markets from now until August.

<u>PRICE OUTLOOK- Assumptions</u>

I have assumed that the world economy will grow faster than last year. I also expect Brent crude oil to trade in a range between 100 and 110 per barrel.

What are the threats to this forecast?

The biggest threat on the bullish side is a weather problem such as a revival of an El Nino or a third successive drought in North America.

On the bearish side, there is a threat of a super strong Dollar prompted by a strong recovery in the US economy. If Quantitative Easing or QE is reduced or Tapered and is finally eliminated, US interest rates may rise and this can lead to a fall in commodity prices.

Conclusion

Currently vegetable oil, oilseed and meal markets are undergoing a small correction. South American supplies are pressuring the market. However, within the next 4 to 6 weeks we must expect new inputs from Planting Intentions and also from Growing Conditions. These will determine how prices behave. I remain reasonably bullish on prices.

I wish my friends in the China crushing and refining industry and my friends in the Dalian Commodity Exchange another prosperous year. Thank you once again to China Cereals & Oils Business Net for inviting me.

Good Luck and God Bless