India Veg Oil Demand Scenario: Impact on Global Prices in 2014

Paper by **Dorab E Mistry,** Director, GODREJ INTERNATIONAL LIMITED
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Ladies and Gentlemen

I am delighted to be participating in this **Malaysia –India Palm Oil Trade Fair and Seminar** organised by 2 distinguished Malaysian organisations: – the **Malaysian Palm Oil Council and the Malaysian Palm Oil Board.** We are honoured and delighted to welcome once again our friends from Malaysia and in particular **His Excellency YB Datuk Amar Douglas Uggah Embas, the Minister of Plantation Industries and Commodities, and our old friend Tan Sri Dr Yusof Basiron.**

This is the first time I am speaking since my paper in Beijing on 22 March 2014 and also the first time since the election of a new Government in India. I have a lot to say so let me go straight to the point of Indian Demand, World Palm oil Supply and the resultant Price Outlook.

Background

At the **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.

I forecast that the then prevalent fundamentals for palm oil were quite tight and that under both scenarios, prices needed 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 you recall, I said 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.

You will also recall that major bullishness came into palm oil as a result of the Mandate announced by Indonesia for use of 10% palm bio diesel in all transport fuels from 2014 onwards plus a larger use of palm bio diesel as a feedstock for electricity generation. This was meant to consume 3 million tonnes of palm oil each year for transport fuels alone. Alongside, Malaysia had also announced a 5% mandate from 1st July 2014 onwards

What has actually happened in reality

We have seen that palm oil prices rose by RM 430 in 8 weeks from 14 January 2014. They peaked on 10 March and then fell 450 Ringgits within 12 weeks.

Why have palm oil prices disappointed? In a nutshell – **the failure of Indonesia to live up to its commitment for use of palm bio diesel in transport fuels.**

The failure on usage of bio diesel has come from the three main producer-exporters of vegetable oil – Indonesia, Malaysia and Argentina. Together, they were supposed to consume an additional 2 million tonnes of bio diesel. All 3 have disappointed and today the credibility of their commitment to bio diesel is in question.

In my paper at the **Price Outlook conference on 5 March 2014,** I had anticipated additional bio diesel demand for Oil Year 13-14 to be 3 million tonnes. **That additional demand was the key factor in bullish predictions for palm oil prices.** Sadly, palm oil producers themselves have not been able to fulfil what they had been promising to the market. In the case of Argentina, the mandate exists but it cannot be fulfilled because of domestic price controls. It is simply not economic to produce and sell soya bio diesel at the current price ceiling. However, Argentina has reduced the Export Tax on bio diesel and this has enabled a spurt on bio diesel production since the last one month. All of this will be exported.

Indonesia's consumption of palm bio diesel in the first 5 months of 2014 is roughly the same as its consumption in the same period of 2013 and nowhere near the mandate. At this rate, Indonesian consumption for Oil Year 13-14 will be roughly the same as 12-13. We are told this is due to a lack of infrastructure for blending and handling. In other words, all the tall talk coming from the highest levels of the Government was made without the slightest knowledge or intention of fulfilment. Whilst this may be one reason, **the real reason could be the high price of CPO and the lack of competitiveness of bio diesel in 2014.** Palm oil prices in 2013 were lower and this made it possible to use more palm bio diesel domestically. Even today, if palm prices fall and bio diesel becomes more profitable to use, we shall dramatically see, as if by magic, the emergence of "infrastructure for blending and handling".

In the case of Malaysia, this is the third time in the last 10 years that Malaysia has quietly postponed the implementation of a national bio diesel programme. Once again, it seems to me the real reason is the higher price of palm oil and the lack of competitiveness of palm bio diesel.

We must ask ourselves the question – Was the palm oil market wrong in taking at face value the assertions of the governments of Indonesia and Malaysia on the subject of national mandates for bio diesel use ?

The latest news from the EU suggests that there is a change in the way the bio diesel mandate will be implemented. In short, it gives greater weightage to Used Cooking Oils and may reduce the amount of vegetable oils like Rape oil consumed in bio diesel.

Palm oil Production

Production of palm oil has been better than expected since February 2014. We have not yet seen any effect of the dry weather earlier in the month of February.

If the El Nino turns out to be mild and delayed, as many weathermen are predicting of late, palm oil production will turn out to be better than my earlier estimates. **My current estimate is for Malaysia to produce 19.7 to 19.9 million tonnes in 2014. Indonesia is expected to produce an additional 3 million tonnes and that will take it to 30.5 million tonnes.** Again it is possible that Indonesian production will turn out to be higher than my estimate.

As regards stocks and the equation of Supply and Demand, the following statistics from Malaysia make interesting reading. During the first 5 months of 2014, Malaysian production was higher than 2013 by almost 524,000 tonnes. On the other hand, exports were Down by almost 790,000 tonnes.

	Jan – May 2013	Jan – May 2014	Difference
Production	6.972 mln mt	7.496 mln mt	+ 524,000 mt
Exports	7.415 mln mt	6.625 mln mt	- 790,000 mt

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

Production prospects for other Oilseeds and Oils

Since March 2014, the prospects for oilseed production in most parts of the world have improved. Both Brazil and Argentina have produced record soya crops. The current soya and corn crops in USA look like breaking all historical records. It was said that Canada enjoyed unimaginably good growing conditions in 2013 and that USA could do so in 2014. Looking at Crop Condition ratings so far, that certainly appears to be the case.

We are already hearing reports of the highest ever planting intentions for soybeans in Brazil later this year. Argentine farmers will have no alternative but to plant and produce more soybeans because it is the most profitable and least regulated crop.

Similarly the prospects for Rapeseed in Europe and Australia and for Canola in Canada are very bright.

Sunflower seed plantings in Ukraine and in Russia are also almost the same as the previous year and growing conditions so far have been good. I have often spoken about the threat of drought in this part of the world but so far, dry weather is mostly confined to the wheat areas in and around Kazakhstan.

So overall, prospects for large oilseed crops look very favourable. However, we must never forget - **There is many a slip between the cup and the lip.**

INDIA

The Indian monsoon does give some cause for concern. However, the most important rainfall in India is from mid- July to the end of August. It is far too early today to cry wolf. Groundnut as an edible oil is not very relevant in India anymore. As for soybeans, even in the cruel drought of 2011, India lost less than 2 million tonnes of beans. As I always emphasize, India produces so little of its edible oil and oilseed requirement during the Kharif harvest that a shortfall has little effect on its S&Ds. The greater impact comes from the hype which leads to inflation. Less rainfall does to some extent affect the generation of hydro-electric power.

Indian demand so far in this Oil Year 13-14 has grown almost in line with historical trends. The only difference is that the excellent Rabi crops have provided more domestic oil and thus imported oil volume has been flat. In the remaining 5 months of the year, we are likely to see a rise in import volumes.

On a related note, I am bullish on the Indian economy with the election of the new government headed by Prime Minister Narendra Modi. From September onwards we should see a powerful Feel Good factor take shape as the Indian economy recovers its growth path. Normally this would lead to stronger growth in per capita consumption. However, if the monsoon rains are less than normal, we may have to wait a bit longer for per cap consumption to show the same vitality.

Inflation will be a major worry for the new Indian Government. Therefore we may not see any immediate change in import duties on vegetable oil. If rains are good from mid -July to late August, we can expect reasonably good crops in India. That would temper the outlook for food price inflation and enable the government to take a fresh look at import duties.

At some stage, perhaps around September we must expect the Indian Government to raise the import duty on Refined oils so as to put the beleaguered Indian Refining industry and the Indian Oleo chemical industry on a Level Playing Field. I also expect the Safeguard Import duties to be implemented on Oleo chemicals which are seriously affected by Indonesia’s Inverted Export Tax structure. It is matter of survival for India’s Refining and Oleo chemical industries.

Imports by India

Palm is losing market share in India, just as we have been forecasting. Only in the last 6 weeks did palm begin to get competitive once again. And no sooner this process started, palm oil bulls have undone most of the good work. The optimism of palm oil bulls and their cheer leaders often amazes me.

SOYA

The higher mandate for bio diesel announced by the Brazilian government from 1st July to 6% and subsequently to 7% before the end of the calendar year is a game changer for soya oil. I believe we have seen the low point for Oil Share.

On the other hand, we have a severely inverted market in soybeans. From their current level in excess of US$ 12 per bushel, new crop November soybeans are expected to decline towards US$ 10 per bushel. So in the face of declining bean futures, it is possible that bean oil futures on the CBOT will not be able to make headway. Therefore, cash premiums or basis will have to do the job.

SUNSEED

Given the excellent competitive position of Black Sea sun oil, prices of sun oil remain very attractive. The weakness of the Ukrainian currency has helped in this regard. We need to keep an eye on weather in this region. If we get big crops, we are likely to see sunflower oil remain very competitive for the rest of the year.

COCONUT OIL & PALM KERNEL OIL

Both Coconut oil and Palm Kernel oil have managed to curtail demand by the lofty levels of their price and need to decline in price.

WORLD DEMAND

World demand for veg oils has been flat so far this year. This may be the result of under-performance by bio diesel users. It may also be due to the lack of strong growth so far. There has also been some de-stocking in the large importing countries like China and India.

I still expect World Food Demand to grow by about 3.5 million tonnes. However, bio diesel demand may grow by only 1.5 million tonnes – mainly from the additional Brazilian mandate. 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, 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**	**+ 5,000**

We can see that World S&Ds are much easier now than they looked at POC in March this year.

PRICE OUTLOOK- Assumptions

I have assumed that the problems in Iraq will be contained and that Brent crude oil will trade in range US$ 100 and 120 per barrel. **Energy prices are critical to bio diesel demand.** If gas oil prices flare up and POGO spreads widen beyond US$ 180 pmt, vegetable oil prices will move higher than my forecast. This is a critical assumption.

PRICE OUTLOOK

I believe prices will depend very much on the development and the severity of El Nino in the medium term.

For the present, palm desperately needs to regain its competitiveness. That means RBD Olein must open up a discount to soya oil on a fob-to-fob value of US$ 120 for the High Production and High Demand months of August, September and October. Palm has become far too dependent on bio diesel demand and that is an unreliable, opportunistic and sporadic market. Palm must fight for market share of edible food demand.

I believe BMD futures on the 3rd month should trade for the next few weeks in a range of 2300 to 2500 Ringgits. Demand will be good at the lower end of this range. At the upper end at 2500 RM, Malaysian stocks will soon exceed 2 million tonnes and work their way to a peak of almost 2.5 million tonnes by November.

If the current dry weather continues beyond the next 2 weeks, it will require a change of view on prices. Temporarily, prices may escalate to 2600 RM but it will severely test demand.

What happens if El Nino develops in the palm belt from mid- August onwards?

Typically an El Nino brings "lower precipitation" or Hot and Dry weather for periods between 8 and 18 weeks. Price reaction will depend on the length and severity of this current El Nino. A weak Indian monsoon will add little to demand but will have a big impact on sentiment. Therefore it is possible that at some stage between now and December, BMD futures may climb to 2800 Ringgits.

We must remember that each 100 RM increase in CPO futures, will raise the bar for Brent crude and for Gas oil prices. At 2700 RM, we need Gas Oil to climb to US$ 1000 to 1020 to catch any discretionary blending demand. It also means Brent crude at US$ 125 per barrel. If energy prices do not climb so high, at 2700 RM, Indonesia will dramatically reduce palm bio diesel consumption.

This is why palm oil traders need to be careful about chasing prices too high. When producer countries do not honour their own mandate, they cannot expect discretionary demand to take up the slack.

On soya oil, I expect CBOT bean oil futures to trade in a range of 38 to 42 cents with premiums doing most of the job. Remember, we are staring at a massive soya crop in USA and November beans should finally trade around US$ 10 per bushel.

Conclusion

I wish to say that at Godrej, we are strong well-wishers of Malaysia. We were the first Indian private sector company to invest in Malaysia in 1962. In 1977 we introduced Malaysian RBD Palm Olein in consumer packs to the Indian housewife.

For India, I am delighted to say the near future looks extremely bright. Malaysia is also on the path of rapid economic growth under its Transformation Agenda. We are united in our desire for a prosperous and sustainable palm oil industry. There is much that our nations can do together. I wish our guests from Malaysia and my own compatriots all the very best for the rest of 2014.

Good Luck and God Bless