Outlook for World Vegoils- 2016

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Ladies and Gentlemen

At the outset may I congratulate the PVMA and sister organisations on organising this **First Pakistan Edible Oils Conference**. My friend Rasheed Jan Mohammed and his team have worked very hard and richly deserve kudos for the success of this landmark event. I thank you all for your great response and for inviting me and for the warmth of your reception.

I have always congratulated my friends in the crushing and refining industry in Pakistan on their resilience and determination. Pakistan has been through difficult times and doing business has not always been easy. And yet the industry has functioned very well. I also welcome the new spirit of dialogue and friendship between India and Pakistan as two good and mature neighbours. May those ties get stronger.

The year 2016 has begun on a strange note with major sell offs in Equities, in Crude oil and in related commodities. The Veg oils market has weathered the storms much better because the fundamentals of Supply and Demand had already begun to tighten from December 2015.

Background

2015 was the year of a severe EL Nino and the effects of dry weather are being noticeably felt in CPO production at present. The Indonesian government and industry have also got together and finally the national Bio diesel programme has got under way. It is not performing to its expected levels but the production and consumption of over 200,000 tonnes of palm bio diesel is good enough to reduce burdensome supplies and stocks.

Crude oil prices have declined dramatically as sanctions on Iran were lifted and we have seen crude oil prices go down to levels we could not have imagined. There have also been some fears about China and its transition from an export and asset based economy to a consumption and services based nation.

Given these and other headwinds, the vegoils market has come through very well and prices have recovered to very remunerative levels.

Once again, India has been the stellar performer. The Indian economy remains an island of high growth in an otherwise shaky world. This has translated into high growth of consumption and import of veg oils.

What Next

We have the all important palm oil conference in Kuala Lumpur next month so any speaker who is going to present a paper here today as well as in KL next month has got to be careful in what he says.

PALM

Through 2015, I have been estimating 2015 Malaysian production at 20.1 million tonnes and Indonesian production at 32 million tonnes. Overall I said I expected world palm oil production to be higher by 2.5 mln mt as compared to the previous calendar year. These forecasts turned out to be somewhat optimistic mainly due to a shortfall in production in November and December. The dry weather of February and early March affected November-December production and we continue to see that effect in the early months of 2016 also.

CPO production in Malaysia in November was almost 19% below October and December was 15.5% below November. This meant that total CPO production in calendar year 2015 in Malaysia failed to reach 20 million tonnes, despite excellent performances in the months of August, September and October. I believe CPO production in Indonesia for calendar year 2015 reached 32 million tonnes as expected.

The declines seen in November and December will have deep impact in 2016. The High Cycle came to an end in October – having lasted from March to October – a normal duration of 8 months. From November we have started a new Low Cycle which is being exacerbated by the dry weather from the EL Nino. It also coincides with the annual low season between November and February. **Therefore we are in for what I can only describe as a Triple Whammy.**

The MPOA advance estimate for CPO production in the first 20 days of January was almost 22% below December. Estimates of January production have been revised accordingly and despite poor macros and poor exports, we are likely to see once again a significant draw down in Malaysian stocks. **This same phenomenon is likely to continue into February and later into March. The anaemic production run is likely to continue until June when this Biological Low Cycle may finally come to an end after a period of 8 months. Consumers may only be able to heave a sigh of relief from July. Replenishment of stocks may take a bit longer – possibly until September 2016.**

I had earlier reduced my estimate of growth in World Palm Oil Production in 2016 to 1 million tonnes.

Since the last fortnight of December, rainfall has again been deficient in parts of East Malaysia as well as parts of Indonesia. Several respected meteorologists have pronounced an end to the El Nino. However, in the last 3 years we are seeing a significant dry patch in the month of February each year. We need to watch this weather very carefully. For that reason it is far too early for me to release an estimate for 2016 CPO production in Malaysia as well as Indonesia. However I would like to say today that it is very unlikely that at POC in KL next month I shall retain my earlier estimate of a growth in world palm oil production in 2016 as compared with 2015.

Indonesian Palm Bio diesel Mandate

The Indonesian Bio Diesel programme has finally got off to a good start. From about mid-November, the consumption of palm bio diesel in Indonesia is running at a monthly rate of about 220,000 tonnes. I believe this is for the present the maximum we can expect. The very low price of Gas Oil – which dipped to almost US$ 250 at one stage on 21st January 2016, has meant a colossal increase in the Subsidy required to make bio diesel consumption workable. It is to Indonesia's credit that the programme is still working. I believe this programme at a rate of 220,000 tonnes can run and be financed comfortably until present Allocations run out in April 2016. We expect new Allocations to be announced in March but the funding and viability of the new programme will be difficult unless gas oil prices recover. Also, looking at the decline in CPO production, it may not be possible to devote as much as 220,000 tonnes of palm oil each month from May 2016 for subsidised bio diesel. It may aggravate shortages and force up prices to levels where palm begins to lose market share.

I estimate that from March we shall see Export Tax being triggered in Malaysia on CPO exports. Around the same time we are likely to see the Inverted Export Tax structure of Indonesia also kick in. This will lead to lower CPO exports and higher exports of Refined and Processed Palm products.

SOYA oil: The long awaited change of government in Argentina has taken place. Export tax has been reduced by 5% and the Peso has been allowed to float. This has resulted in a de facto devaluation of almost 40 %. For a while cash soya oil prices came under pressure in December and early January. However, the re-introduction of Blenders Credit in USA for bio diesel has helped to stabilise soya oil futures on the CBOT and soya oil prices have recovered.

Brazil and Argentina are on course to harvest bumper crops and the Brazilian Real has also come under pressure. Yet by and large the soya complex has shown resilience.

On the Demand side, soya oil has gained demand from sun oil and from palm oil. The country where this substitution has been most evident is India.

I remain friendly to soya oil but the nearby outlook for palm oil looks stronger for the next 4 months.

Rapeseed / Canola: The outturn in Canada has surprised all of us by the recovery of the 2015 crop. In India too the outlook for rape-mustard is now better than we had expected and the crop is likely to be an improvement over the disastrous crop of 2015.

Sunflower oil: Sun oil priced itself at too much of a premium and is steadily losing market share to soya oil. This is despite very weak currencies in Ukraine and Russia. We must keep our fingers crossed that Ukraine and Russia will again produce big sun seed crops in 2016.

Lauric oils: Coconut oil production has not recovered as much as expected. Some of the loss is due to a long term shift towards farming younger coconuts for Coconut Water rather than for Copra and CNO. Coconut water continues to expand its market and this may be responsible for keeping the supply of Copra tight. Palm Kernel production has suffered in line with CPO production. The end result is that both lauric oils are far too expensive. Oleochemicals are losing ground to petro chemicals and this is not good for the long term health of our industry.

INDIA: I have updated the figures which I generally use to demonstrate how palm oil is losing market share in India. The world's swing consumer is India and it is in this market that price relationships between oils are determined.

000	2015-16	2014-15	2013-14	2011-12
Soya oil	4,200	2,986	1,951	1,080
Palm oil	9,750	9,478	7,960	7,670
Sun oil	1,200	1,542	1,510	1,140
Laurics	200	250	220	200
Others	250	356	200	100
Total	**15,600**	**14,612**	**11,818**	**10,200**

What is at once noticeable from this table is that India's imports have soared by almost 50% in the last 4 years. Palm tonnages have increased by only 25% in these 5 years while soya oil has recorded an increase of over 370%.

This year if India has a good Rapeseed crop, the local demand for soya oil may weaken and that will give Palm a chance to regain some market share. This is all Work in Progress. Palm is also fortunate that for the next several months, the availability of palm will be tight due to the fall in production.

CHINA: China continues to concentrate on soybean imports and to crush locally for oil and meal. The feature of 2015 was the fall in Chinese veg oil imports. These are unlikely to recover in 2016 but they will also not decline further. China has been releasing small tonnages of its massive 6 million tonne Reserve Stock of rape oil. This is a step in the right direction and must be continued.

China dominates the economic news for the last several months. As I have said before, the Chinese economy is in a state of transition. **I remain a long term bull on China and believe the economy will emerge stronger, more vibrant and more diversified as a result of the present re-structuring.**

Energy Demand: The US EPA already announced its proposals. The Indonesian bio diesel programme is also now functioning well. **I am estimating that world energy demand will expand in 15-16 by more than my previous estimate of 1.5 million tonnes.**

World Demand

Low prices have given us a robust increase in food demand by 4 million tonnes in 14-15. Growth in 15-16 is likely to temper to 3.5 million tonnes.

I am not in a position to present fresh World Incremental S&Ds because several points need more work to be done. We need to get a better handle on palm oil production and also on growth in world bio diesel demand.

What I am doing today is simply repeating the figures which I had presented in November 2015 in Bali. Please read the Caveat below:

000	**Oct 13-Sep 14**	**Oct 14-Sep 15**	**Oct 15 – Sep 16**
Soya oil	+ 1,800	+ 2,700	+ 3,500
Rape oil	+ 400	- 300	- 1,500
Sun oil	+ 1,600	- 600	-
Gn & Ctn oil	-	-	- 300
Palm oil	+ 3,400	+ 1,600	+ 1,000
Lauric oils	+ 300	+ 200	+ 400
Supply Increase	**+ 7,500**	**+ 3,600**	**+ 3,100**
Demand Increase	**+ 5,200**	**+ 2,500**	**+ 5,000**

The Gap between Incremental Supply and Incremental Demand will turn out to be much greater because Supply is shrinking whilst Bio Diesel demand due to Mandates and Subsidies is Increasing. This will have a profound impact on veg oil prices during the rest of this year.

PRICE OUTLOOK – Assumptions

I am assuming Brent crude oil to trade in a range US$ 30 to 50 per barrel.

I am not expecting the FED to increase interest rates until the second half of 2016

I expect the Malaysian Ringgit, the Indonesian Rupiah, the Brazilian Real and the Argentinian Peso to have bottomed out and to be stable against the US Dollar.

PRICE OUTLOOK

I believe Palm oil futures on the third month of the BMD will comfortably rise to 2600 Ringgits very quickly. Further rise will depend on crude oil prices. It is just possible that in Q2 we see very tight stocks in Malaysia and that propels palm oil to 2700 Ringgits too. RBD Olein AMJ can rise to US$ 670 FOB.

Soya oil: I had earlier forecast that soya oil futures on the CBOT will rise to 33 cents and they soon fulfilled that forecast. I believe that rise was too quick and inevitably those gains were given up very soon. I expect soya oil futures to climb once again to 33 cents but I also expect the cash basis in Argentina to fall.

I believe cash soya oil fob Argentina will find it difficult to exceed US$ 700 FOB
It is possible that for a short time, RBD Olein FOB and crude soya oil FOB will be very close in price
Sun oil prices are unlikely to do much from current levels
Rape oil prices will remain at a premium to soya oil but at a small discount to sun oil.
I expect Palm Kernel oil to trade in a range of $ 900 and 1000 CIF Rotterdam. Coconut oil is over-priced and will retain a premium of about US$ 200 over CPKO.

Conclusion

The industry in most parts of the world is in good shape. Food demand is robust and we can look forward to better times. The new factor is the decline in production of palm oil as a result of the El Nino of 2015. We also have the upcoming US Panting season and the weather outlook for North America.

Price outlook for 2016 will be influenced by the outlook for mineral oil prices. A great deal also depends on palm bio diesel consumption in Indonesia.

I shall end by drawing your attention to the paradox of the last Asian Financial Crisis of 1997. All commodities and Equities in 1997 fell dramatically in price – except Vegoils spurred by the EL Nino of 1997. Is History going to repeat itself after the EL Nino of 2015?

Good Luck and God Bless.