

The Outlook for Vegetable Oil & Tallow Markets

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Ladies and Gentlemen

I am delighted to be in Sydney at the **11th Symposium of the Australian Renderers Association**. Sydney is always a great city to visit. Australia epitomises the commodity boom-led prosperity of a nation. Amidst the euphoria caused by the boom in mining, it is salutary that grains, oilseeds, wool, meat and pulses are holding their own. This is where long term sustainable employment and prosperity reside.

Tallow has been banned from India for the past 3 decades and therefore Indian traders of my generation used to neglect a study of this market. That changed a few years ago as bio diesel began to make an impact and tallow began to be used as a feedstock. Recent preferential treatment in terms of GHG emissions, for tallow and animal oils has given tallow almost centre stage and made it imperative for analysts like myself to study tallow S&Ds once again.

We meet at a very interesting time because world veg oil markets have been resisting any decisive break southwards.

I have not spoken publicly about the new emerging world S & Ds since my speech in Beijing on 4 April 2011. At that time you will recall I had said that the recovery in palm oil production during 2011 was going to be much stronger than predicted earlier and that palm oil prices would decline decisively to 3000 ringgits before rallying again sometime towards the end of the calendar year 2011.

Developments in Palm oil complex

We came in to 2011 after almost 2 years of declining crude palm oil (CPO) production both in absolute terms as well as in yields. Palm trees have had a restful phase of almost 2 years and are now performing as never before. We also have to take into account that there has been some hitherto unaccounted new planting particularly in Sabah and over portions of Indonesia. This is quite understandable given the problems involved on obtaining land clearances. We only come to know of these new hectares when they start yielding Fresh Fruit Bunches which are brought to market.

Hence as a result of higher acreage and much better performance, CPO production in Malaysia and Indonesia and indeed in almost every other country will record sizeable increases in 2011.

My latest estimate for CPO production in Malaysia for calendar year 2011 is 19 million tonnes. That is a massive 2 million tonnes more than the previous year. Similarly, I have raised my estimate for Indonesian CPO production to 25.5 million tonnes, which is 3 million tonnes more than the previous year. The chances are that my estimate will be comfortably exceeded. Again, we have a strong recovery in tree output plus a strong increase in mature area prompted by the high prices of 2007 which led to above trend growth in acreage.

I have to say that CPO output in PNG as well as in Thailand and even in South American countries like Colombia is recording significant growth. Even in India, we are seeing a growth of almost 30% in FFB production this year over the previous year. So overall I estimate world Palm Oil production in 2011 will be at least 6 million tonnes more than the previous year. I shall not be surprised if I have to raise this figure to 6.5 million by September speech!

Extending that estimate a bit further, I reckon Crude Palm Kernel Oil (CPKO) production will be higher by at least 700,000 tonnes. Coconut oil production was down in the first half of the year but is coming back and will recover after July. Overall CNO production will be lower by 200,000 tonnes from the previous year. Hence Lauric oils supply will expand by a net 500,000 tonnes. That brings us to various other oils.

Soybean oil

We are in the midst of the US Weather market and it will be premature for me to estimate US soybean or corn crops. On the other hand, we cannot ignore the fact that the 2011 soybean crops in Argentina, Brazil and Paraguay were much better than expected. If the US soybean crop comes up to the USDA estimate of its July Report, we can use that as a good basis for estimating Incremental Growth in soya oil production. By common consent, we came into 2011 with very large stocks of soybeans. Therefore it has been safe to calculate an increase of almost 12 million tonnes in the soybean crush. I reiterate my estimate that soya oil production will be up by almost 2 million tonnes in 2011.

Sunflowerseed oil: The production of sunflowerseed in Argentina exceeded expectations. The current crop in Russia and Ukraine as well as in the EU promises to exceed that of last year by at least 2million tonnes. My estimate is that world sun oil production will rise in 2011 by about 1 million tonnes

World production of groundnut oil is expected to be stable. On the other hand, world production of cottonseed oil is expected to be higher by almost 500,000 tonnes.

Rapeseed oil: That brings me to the only seed oil where there is a decrease in production in 2011. Rapeseed and Canola seed production is under strain. European production is significantly less than the previous year and prospects in Canada also do not look too bright. On the other hand, production in India and Australia is better. China is down by at least 1 million tonnes. Overall I estimate Rape oil production in 2011 will be down by 500,000 tonnes.

At this stage I would like to pay tribute to the Australian Oilseeds Federation where I spoke a couple of years ago, on the success of Rapeseed cultivation in Australia. After a few difficult years, rapeseed cultivation is back on growth track. The world needs more rapeseed and Australia is well placed to take advantage of that opportunity. May I, at this point also mention my own and our company GODREJ's long relationship with Gardner Smith and their distinguished Chairman Mr Don Seaton.

I now come to the DEMAND side.

In my paper at the Price Outlook Conference in Kuala Lumpur in March this year, I explained at length and drew attention to the explosive situation with regard to U S bio diesel as a result of RFS 2. Expectations have been very high. Production of bio diesel in USA is climbing each month but the proportion of soya oil used in bio diesel is not rising. It stays stubbornly at about 50 %. This means the US bio diesel producers are able to find increasing amounts of tallow, grease and Used Cooking Oil each month. This has kept a lid on domestic soya oil prices. However, this factor will keep driving up the price of animal by –products and keep them away from edible consumption. It will create greater opportunities for palm and canola in USA this year.

Bio diesel mandates are now also in force in Argentina and likely to be enhanced in Brazil. A mandate has also come into force in Canada recently. My estimate remains constant that world bio diesel demand in 2011 is increasing by almost 3 million tonnes.

As regards food demand, the world economy will continue to grow at a fair pace, driven by BRIC countries and others like Indonesia. I expect food demand to expand by about 3.5 million tonnes. It will be driven by growth in population and a rise in living standards in the developing world. Food Demand could have expanded by 4 million tonnes had prices fallen further, particularly in the case of palm oil. So far we have seen that 3000 Ringgits has been a solid support for CPO prices and that has prevented any significant growth in per capita consumption in price sensitive markets like India.

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

000 tonnes	Jan to Dec 2011
Soya oil	+ 2,000
Rape oil	500
Sun oil	+ 700
Gn oil & Cotton oil	+ 500
Palm oil	+ 6,000
Lauric oils	+ 500
Total Increase	+ 9,200
Demand	+ 6,500

It can be seen that the increase in world supply will outstrip the increase in world demand for the first time in the last 3 years. This is very significant.

It is also seen that world stocks will rise significantly. This rise in stocks will materialise mainly in the second half of the year. That is when palm oil production will be at its highest and Russian and Ukrainian sunseed crush will be strong.

Sustainable Palm Oil and Indirect Land Use Change

Recently the EU has postponed any decision with regard to Indirect Land Use Change. A prominent analyst quipped that Palm Oil had dodged a bullet!

I am afraid that is the reality. During 2011, as a result of the discriminatory Export Taxes levied by Indonesia, the export of Palm bio diesel has become workable and large tonnages have been exported to Europe. It would be fair to say that CPO prices have held up primarily because of this extra bio diesel demand from Indonesian producers. If ILUC were to be invoked to the detriment of Palm oil, such palm bio diesel demand would evaporate. The EU is expected to make a decision later this year and it will be watched with great interest.

In the meantime, the Round Table on Sustainable Palm Oil under its new CEO is making confident strides. More Green palm oil certificates are being taken up. The palm oil industry as a whole has done a great deal to clean up its act and to convince

the sceptics that palm oil cultivation in a sustainable manner benefits the millions of people who live in this region. Above all, palm plantations provide vegetable oil to the developing world at affordable prices.

Discriminatory Export Taxes in Indonesia

I have often spoken out on this issue. It is a great disappointment that the Indonesian plantation industry has stopped protesting against these taxes and has acquiesced meekly. Perhaps the time has come when those who suffer as a result of such export taxes, the millions of palm oil consumers in the developing world, will be forced to take up some retaliatory measures. In India there is a strong lobby to re-impose import taxes on CPO and to raise import taxes on RBD Olein. It would be so much better if good sense prevailed and the Indonesian government abolished or drastically reduced these Export Taxes.

PRICE OUTLOOK

There are some major uncertainties which we face this year. The problems of the Euro Zone with regard to sovereign debt will remain with us for some time. The net effect of this problem could be a strengthening of the US Dollar to the detriment of the Euro.

On the other hand, the problem of the twin deficits in USA and the sheer lack of will to do anything about them in this pre-election period must weigh on the Dollar.

So the U S Dollar is torn between the problems of the US and the problems of the Euro Zone. Is it any wonder that the price of Gold and precious metals keeps escalating? By the same token, one must keep in mind that investment in commodities will remain an attractive option.

In other words, we remain in a high risk environment. Risk is high that commodity prices and indeed asset prices will surge as the Dollar weakens. And risk is also very high that if we have another financial or stock market collapse, the Dollar will strengthen as the least bad currency.

Over and above these factors, we also have to reckon with the threat of higher crude oil and energy prices. My prognosis is based on WTI crude trading in the range of US \$ 85 to US \$ 105 per barrel.

With those caveats I proceed to explain my price forecast for the next 6 months

PALM – I expect CPO futures on the BMD to trade in a range between 3100 and 3300 for the next 6 weeks. We are in the midst of a weather market in the US with a possible crop scare rally. Therefore despite bearish fundamentals, palm futures will be well supported. August CPO production will be affected somewhat by the Ramadan holidays and export demand in summer for palm will be strong. As we go into September it could be a different story. The peak summer demand will have gone, Indonesian bio diesel production will slow down dramatically and CPO production will rise strongly in September and October. I expect palm stocks on 1st December in Malaysia to be at a record high. All this will weigh on palm futures and the BMD could break 3000 and go lower. I believe the lowest will be around 2800. Around the same time, the discount for RBD Olein compared to Crude Degummed Soya oil will be at a new peak of US \$ 250.

How long will low prices last? That will depend on the length of the biological High Cycle for CPO production. At present it looks like that High Cycle will remain in force until early December 2011. The legacy of high stocks will continue to pressure prices for some time. I am expecting prices to reach a Low in September and to scrape along that bottom for at least 4 to 6 weeks. Then a gradual recovery will ensue.

In my POC paper in March this year, I had forecast a rally in the last quarter of the year with prices once again moving towards 4000 Ringgits. I am changing that prognosis today. The strength of the CPO production growth and the stocks that are likely to be remain stubbornly high leads me to believe the rally will be postponed to January 2012. The level of 4000 ringgits will take time, possibly not until April 2012.

Soybean oil – Bio diesel demand in Brazil as a result of the national mandate and bio diesel production for export and for the new local mandate in Argentina has kept soya oil prices steady at the level of about US \$ 1250 FOB. Export demand for edible soya oil has been eroded by the large discount that has opened up with RBD Palm Olein. This erosion of demand, mainly in India and other price sensitive markets will continue. I expect soya oil prices to continue to be steady around the US \$ 1250 FOB mark for the next several months. They will encounter competition from sunflower oil on the one hand and from RBD Palm Olein on the other.

U S bio diesel will fulfil expectations in terms of tonnage but the somewhat surprising factor has been the stagnant share of soya oil as a raw material. As a result, soya oil prices will not reap the major uplift that I had earlier expected. Soya oil prices will only rally around December-January as we approach the end of the South American crush season. The soya oil premium over palm oil will narrow as a first step before we see any gains in soya oil.

Sunflower oil: Sun oil will gain in popularity and usage as it will be available for most times at a very small premium to soya oil.

Rapeseed oil: I expect Rapeseed oil prices to remain at a premium to sun oil and to enjoy strong demand for bio diesel. The higher price of Rape bio diesel will create opportunities for Palm bio diesel in Europe from May 2012.

Lauric oils: Palm Kernel oil presents an interesting case. World demand for lauric oils is likely to expand by about 300,000 tonnes in 2011. On the other hand, world production of lauric oils (CPKO and CNO combined) will rise by 500,000 tonnes. We have already seen a very big decline in CPKO prices from a high of US \$ 2200 to current levels of \$ 1300 CIF Rotterdam. CPKO prices will have to go low enough to re-discover edible demand. That means a premium of around \$ 100 to the price of RBD Olein. Hence CPKO prices have room to fall to around \$ 1150 CIF Rotterdam. CNO prices also have room to fall once copra production is back on stream. For 2011, CNO will remain at a premium to CPKO.

Tallow: As I have mentioned before, I am surprised at the strong availability of non-soya oil raw material to the US bio diesel producers. On top of that, tallow is also a favoured raw material for bio diesel in Europe. Therefore tallow and grease prices will go to a premium over palm stearine and find usage mainly in bio diesel. If Indirect Land Use Change norms are taken up by the EU and Palm oil becomes a victim of such

a regime, all bets on tallow prices will be off. Therefore, as producers of tallow, you should follow EU developments very closely. The commissioning of specialist bio diesel plants that can produce the equivalent of Arctic Diesel is another exciting development for tallow.

Conclusion

The year 2011 will go down in history as a bumper year for vegetable oil production. And yet prices have held very close to their highs. World production will rise by about 6% this year. In the past we learn from history that production rises of 5 to 6 % push prices into a bear market. It is a sign of the changed times that we have not even caught sight of what may be called bear market prices.

For this development we have to look to bio fuels. They have acted as a bridge between high priced energy and low priced oils and fats. You as producers of tallow have a lot to thank bio fuels for. As processors and users of veg oils, we in India, say Thank God for Palm oil.

We have seen over the last 20 years that annual incremental growth in veg oil supply depends chiefly on growth in palm oil. It is amazing how productive this tree is and will be in the years to come. The challenge for the industry is to raise productivity even more and to commercialise the new hybrids that will give us 10 to 12 tonnes of palm and palm kernel oil per hectare. Current high prices have made the industry extremely rewarding. With those remarks, I want to thank the ARA for inviting to speak at this Symposium and an excuse to visit your beautiful country. I wish your industry great success in the years to come and look forward to meeting many of you at veg oil conferences in the near future.

GOOD LUCK and GOD BLESS