

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

Paper by **Dorab E Mistry**

Director, Godrej International Ltd.

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Ladies and Gentlemen

I am delighted to speak in this great city of Beijing at the **8th International Conference hosted by China Kingrain Website**. I also congratulate the Dalian Commodity Exchange and Bursa Malaysia on their efforts to expand the futures market for palm. And ofcourse I appreciate the sterling work done by MPOB and MPOC.

This year we are seeing volatility as we have never seen before and it has become necessary to offer comments regularly on the rapidly changing price outlook scenario.

Before I start, I would like to offer my deepest condolences to our Japanese friends and in particular to friends and colleagues in JOPA.

I shall keep referring to my recent speech on **9 March in Kuala Lumpur at the Price Outlook Conference** and update my price outlook over the next few months. The forecasts I made at POC can be summarised as follows:

Phase One: I expected strong prices to continue for the next few weeks after 9 March on the back of very tight stocks, high energy prices and the run up to the USDA Planting Intentions Report released on 31st March. My expectation was that CPO prices on the BMD 3rd month would move closer to 4000 Ringgits as a result of all these bullish factors.

Phase Two: After that initial advance, I expected prices to begin to descend as palm oil production picked up seasonally and then in July when the biological cycle was expected to turn decisively upwards. My forecast was that CPO prices would be supported at 3000 Ringgits. If you recall, I described in detail the **Indian Biting Point of 3000 Ringgits** at which point I expect strong support in the local Indian market and consumption to begin to rise once again.

Phase Three: After August, I expected the US bio diesel production to begin to increase significantly and that factor to lead prices higher. I forecast CPO prices to once again challenge 4000 Ringgits around December 2011.

What has actually happened so far?

As you all know, the market was not in a mood to accept my figures of potential U S bio diesel production and its impact on the domestic U S demand for soybean oil. The U S bio diesel story is a bullish story but it is not a story for March 2011. It is more a story for Second Half 2011. We also had a sharp downturn in palm exports giving us some evidence of demand rationing due to high prices. As a result, palm stocks have not fallen to the levels expected and have remained comfortable. The unfortunate events in Japan, the earthquake and the tsunami also led to massive liquidation in all commodity markets and in particular for the palm and soya complex. Hence I must be frank and admit that the first phase of my forecast must be abandoned.

Phase Two: We have moved straight into the Second Phase of my forecast. That phase I may remind you was the bearish phase and was expected to last about 4 to 5 months with CPO prices going all the way down to 3000 Ringgits. As you know, within the first 4 weeks after POC, we have seen palm prices slide to a low point of 3163 Ringgits and then recover by almost 200 Ringgits. This is just one example of the kind of rapid price movements and extreme volatility we are going to see this year.

Why has this happened? The first and most important reason has been the **demand rationing** that has been happening in the developing world and also in the more prosperous markets of the Middle East and

North Africa during the period January to March 2011 as a direct result of high prices. The political turmoil in several countries also has curbed consumption. The very poor exports of February and March confirmed this suspicion.

Normally, vegetable oil prices at the level of US\$ 1250 CNF would not have led to such tightening of demand. However, consumers have been faced with all round price rises in food items. Food inflation in general has been very high. Official figures talk of inflation in double digits running at 11% to 14 %. In reality, it has been much higher perhaps even as high as 25 %. Hence we saw a strong impact on consumption. To that extent I was wrong in my Phase One forecast. I ignored this demand curtailment and was swayed by the higher possibilities for bio diesel demand. However, as I have said previously, it is now accepted that bio diesel is a story for the Second Half of 2011 and not the first half.

Traders, shippers and importers in the private sector in the Middle East and North Africa have also become nervous and have reduced inventories and are buying as little as necessary in view of the higher political risk. This is not unnatural and will lead to accumulation of higher stocks at origin in the weeks and months to come. Traders in many countries like India have painful memories of 2008 and are reluctant to rush in to buy after the initial drop in prices.

Recent developments in bio diesel demand.

Thanks to the large impact of the export tax in Indonesia, the local price of CPO in Indonesia in the domestic market is about US\$ 850 only. At that level it is the cheapest feedstock for the manufacture of bio diesel. This has led to strong demand for Indonesian palm bio diesel and almost all the plants are running at full capacity. This means additional palm demand of almost 100,000 tonnes per month as compared with the same month in the previous year. This has created some bullish sentiment but I hasten to add that most of this demand is simply replacement demand and not new demand. **Cheaper palm bio diesel is simply replacing more expensive soya or rape bio diesel.** Also, this additional demand in Indonesia is the result of the export tax and as the export tax declines, this advantage will begin to disappear.

Post POC developments

After the Price Outlook Conference in Kuala Lumpur on 9 March, within the last one month there have been a few new developments and these are impacting some of my estimates.

CPO production: I normally do not re-visit my CPO production forecasts within the first couple of months. This time it is different. The velocity of CPO production in Indonesia is much better than I had expected and the results for the first 3 months of Jan, Feb and March indicate that I have seriously underestimated production. Jan-March 2011 is seriously in excess of Jan-March 2010. Based on that fact and estimating that the improvement will continue for the next 9 months, **I am today forecasting an increase in 2011 of 2.5 million tonnes over 2010. In my opinion, Indonesia production for 2011 will reach 25 million tonnes.**

CPO production in Malaysia in Feb and March has also been better than expected. This improvement is likely to continue for several months and the biological upturn may also kick in earlier than expected. It is not unprecedented that the Low Cycle is shorter than earlier precedents. The heavy rainfall we saw in December and earlier months will manifest its beneficial effect in 2011. I am not putting a figure yet but I am posting a warning that my earlier estimate of Malaysian production at 17.3 million tonnes may turn out to be too low. Based on data available, I hope to be able to release a new figure at my **next paper at Globoil International in Dubai on 15 May.**

Export demand for palm: This has been soft in the first quarter of 2011. Currently palm has moved to a good discount to soya oil and is re-gaining some but not all of its lost demand. The problem for palm is the weakness in sunflower oil which is the preferred oil in many Middle Eastern markets and is once again at affordable levels.

Supply Side: We have also seen greater availability of sunflower oil from Russia and Ukraine. It is now clear that Russian imports of sunflower oil in January were mis-guided. The softness in sun oil prices clearly points to much better availability than hitherto considered. We also have the prospect of larger plantings of sunflower seed and rapeseed in this region in 2011, as a result of the high prices of 2010.

On the supply side, one final point: The Indian rapeseed crop has come in better than expected and farmers are in a mood to bring the crop to market. **We have the unusual but not unprecedented**

situation where in local Indian markets in the interior of the country, mustard oil is cheaper or the same price as imported CPO. Indian imports of palm in April and May 2010 were subdued and really took off from July 2010. This year, we had expected palm imports to recover substantially in May and June if our target of 8.8 million tonnes was to be achieved. I shall speak in more detail on this point next month after reviewing the flow of palm shipments to India in April but I have to say I am not optimistic. Palm has competition from local oils and as I have pointed out, in the heartlands of Central India, palm does not have any price advantage these days. This situation will continue in my opinion until the pressure of arrival begins to wane, towards the end of May or if palm prices decline to 3000 Ringgits. Given this situation, it is very unlikely that India will step up its imports of soya oil also during this period. On the other hand, the very competitive prices of sunflower oil will ensure that sun oil imports are maintained at previous levels.

Some remarks on China

As we know, the government of China has been most concerned about food price inflation during the past 12 months. Most of the steps they have taken were pro-active and positive. They did all the right things that a caring government should have taken. I have some displeasure about the use of informal measures of price control. Thankfully this turns out to be a short term measure.

Based on my revised price outlook which I shall unfold shortly, the government of China should be pleased to know that food price inflation should moderate in the coming months. Part of the problem was that in 2010, we were comparing prices with very low levels of price that prevailed in 2009. Now in 2011 the effect of that low base will be removed. Besides, world weather in 2011 so far has been much better. Even the La Nina in South America was muted and the soya and corn crops have been much better.

So I have some happy tidings for the governments of China and also of India. Food price inflation will be lower for most of 2011 than it was in 2010.

The Chinese government policy of holding large stocks as State Reserves has been fully vindicated in 2010 and in 2011. It was a master stroke to build up Reserves of Rapeseed oil and the periodic release of this oil has broken the back of speculators and kept domestic prices in check. This is something the Indian government could emulate.

It must be noted in future that vegetable oil imported or procured by China for its State Reserve gets counted as Demand whereas it actually gets converted into Supply in the following year!

An Update on Incremental Supply and Demand for 2011

Bio diesel Demand: Many traders have asked me if my estimates of U S bio diesel production and demand for 2011 were correct or if I have been mistaken. Let me confirm here today that I absolutely stand by the figures I presented in Kuala Lumpur. These figures are from U S legislation and not a figment of my imagination. It is true that current U S bio diesel production is nowhere near those levels. I shall simply say that U S bio diesel is going to be the story of the Second Half of 2011 and we shall have to trade them later in the year. **I shall call the bio diesel situation as The Gathering Storm of 2011.**

As I have already pointed out, bio diesel demand has been very strong in the case of palm diesel. There is also expectation that Malaysia will announce a bio diesel mandate effective from June and that Indonesia will announce a mandate also around the same time. We have to wait for these developments to actually happen but the possibility certainly does exist. The high price of crude oil and the expectation that high crude oil prices will last for the next several months must keep bio diesel demand buoyant. The big question remains on U S bio diesel demand. So far, production of bio diesel in USA has not picked up but there is expectation that April onwards the pace of production will increase. U S domestic cash basis has been hardening and if soya oil use in bio diesel picks up dramatically, U S soya oil prices will rise. There is now little prospect of an increase in soya oil exports from USA given the stronger basis. Later over the next few months, I expect to have to raise my estimate of worldwide additional bio diesel demand for 2011 from 2.5 million tonnes to 3 million tonnes.

Food Demand: So far this year, Food Demand has been a disappointment. The political problems in the Middle East and North Africa mean that about 10 % of the world's population will see little or no economic growth in 2011. In fact the economies of some countries will contract. There is also a strong likelihood that higher interest rates and monetary tightening will trim the growth rates of China and India too. At current high price levels, it seems doubtful that Food Demand will grow by more than 2.5 to 3 million tonnes.

Therefore, I am increasing my estimate of Incremental Demand from 5 million to 5.5 million tonnes. This figure can rise further if and when U S bio diesel production takes off and rises in line with legislated numbers.

Incremental Supply

Soya oil: It now appears probable that the additional tonnage of soybean crush which has been estimated at around 15 million tonnes will actually take place. In my KL paper I had expressed some doubt unless soya oil prices rose much further. The recent rise in the price of corn and soya meal will ensure a higher crush and we may even exceed 15 million tonnes of additional crush. The supply of extra soya oil will therefore exceed my earlier estimate and come to almost 3 million tonnes.

Rapeseed oil: It is certain that in 2011 Canola plantings in Canada will greatly exceed the acreage of 2010. Similarly the planting of Rapeseed in Ukraine will also be higher. We already have a bigger Rapeseed crop in India. Therefore with expectation of more comfortable supply of Rapeseed in the future, current worldwide crushing will expand. I reckon the production of Rapeseed oil in 2011 will be at least the same as in 2010, if not slightly higher.

Sunflower oil: Recent news suggests that the Sunflower seed production in Ukraine and Russia was somewhat under-estimated for the 2010 harvest. Sun oil production and exports from these countries are higher than anticipated and the price premium of sun oil has eroded. The sunseed harvest in Argentina is also better than estimated. Therefore sunflower oil production in 2011 will be at least as much if not slightly higher than in 2010.

Palm and Lauric oils: As I have already explained, world palm oil production in 2011 will be at least 3 million tonnes higher than in 2010. Lauric oils are likely to be higher by only about 100,000 tonnes with Coconut oil production lower whilst Palm Kernel oil production will be higher.

Conservatively, we can see that Supply will be higher by 6 to 6.5 million tonnes whilst Demand will expand by 5.5 million tonnes. After a gap of 2 years, Incremental Supply will exceed Incremental Demand.

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

000 tonnes	Jan to Dec 2011
Soya oil	+ 2,500
Rape oil	-
Sun oil	-
Gn oil & Cotton oil	+ 500
Palm oil	+ 3,000
Lauric oils	+ 100
Total Increase	+ 6,100
Demand	+ 5,500

It can be seen that primarily as a result of the higher increase in palm oil production for Indonesia, the Incremental S&Ds have changed dramatically. There is undeniable evidence of rising palm oil production and that is why I have changed the figures within just one month of my earlier paper.

It can be seen that we now need higher U S bio diesel production in order to preserve current high prices. If the U S bio diesel production does not pick up immediately, then current prices must decline in order to stimulate food demand.

RSPO

At this juncture I am delighted to see the Round Table on Sustainable Palm Oil make new positive strides under its new CEO of whom there are great expectations. From what I have seen so far, RSPO is poised for better and more positive things all round. I am delighted to hear of China's stronger interest in RSPO and the possibility of an RSPO representation in China being worked out.

PRICE OUTLOOK

I believe my price forecasts as projected under Phase Two and Phase Three will unfold during the remainder of this year.

As usual my forecast will be affected by any major calamity or political upheaval. Any major financial crisis or a major currency development will also affect my forecasts. Also, if crude oil prices keep advancing and exceed US\$110 per barrel for a length of time, vegetable oil prices will need to go higher.

What are the threats to this forecast?

The threat of Contagion is the most prominent. Equity and bond markets need to be stable and must not fall. Countries like Ireland, Greece, Portugal, Spain or Belgium need to keep their house in order. The flow of investment money into commodities must also remain stable.

Within these caveats my price outlook is as follows:

PALM – I expect CPO futures on the BMD to gradually decline to a first support level of 3000 Ringgits. This is as you know my Indian Biting Point. Given the larger CPO production forecast and the effect of the Indonesian Export Tax being wound down, I expect the 3000 Ringgit support to be penetrated and prices could go even lower. However, at lower levels it will be a buying opportunity.

After August or whenever soya oil usage in U S bio diesel production is substantially raised, we shall see prices rally. A few weeks after that development, prices can begin their journey towards 4000 Ringgits. However, I emphasize we need U S bio diesel and soya oil usage therein to rise substantially before this can happen.

Soybean oil – Current demand for soya oil from South America is soft and the behaviour of the basis in Argentina bears this out. Soya oil prices should decline from current levels of almost US\$ 1250 for May/June/July to about US\$ 1150 in order to regain food demand from its traditional markets. Once the U S soy crop has been successfully planted and prospects look good, soybeans should come under pressure until a crop scare rally takes hold.

Going forward, we have to depend on U S bio diesel production to see if soya oil can rally and forge ahead towards 70 cents per pound in Chicago futures. We must remember that S&Ds are tight and we cannot afford a weather problem in any major growing area.

I expect Soya oil to go to a premium of almost US\$ 200 over the price of palm oil around August 2011.

Sunflower oil will maintain a small premium over soya oil but may also go to parity with soya oil at some stage

I expect Rapeseed oil prices also to maintain a small premium over soya oil for the rest of the year.

I expect Palm Kernel oil to trade in a range of US\$ 1900 to 1600 CIF Rotterdam with Coconut oil trading about US\$ 100 higher at any given point.

Conclusion

I once again repeat what a great pleasure it is to be here in Beijing thanks to Kingrain High Technology Company and I wish them well for the future.

Whilst we have great volatility this year, we must keep our minds alert. The Gathering Storm of 2011 should not blind us to the urgent need to regain food demand.

My next paper will be on 15 May 2011 at Globoil International in Dubai

Good Luck and God Bless

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