Outlook for World Vegetable Oil Prices

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at 5th CHINA International Oils & Oilseeds Conference by
Dalian Commodity Exchange & Bursa Malaysia
at Shangri-La Hotel, Guangzhou on 7 November, 2010

Ladies and Gentlemen

I am delighted to speak at this 5th Annual China International Oils & Oilseeds Conference in the beautiful city of Guangzhou.

At the outset may I congratulate the **Dalian Commodity Exchange** on the recording breaking turnover that it continues to achieve year after year. As always I salute my friends at **Bursa Malaysia** on what they have done over the years to sustain and develop the futures market for Palm Oil.

I am particularly happy to be speaking on this occasion because all my predictions with regard to palm oil production and price behaviour have come true so far. On top of that, I am particularly happy that my optimism on the World Economy has verified and the Central Bankers have by and large followed wise and expansionist monetary policies. China and my own native country India have been leading the world out of recession. This fact has given me much happiness and satisfaction.

To make a quick recap, I have been saying since 4 December 2009 that we are facing a problem on palm oil production in 2010. Initially people were sceptical about my prognosis but these days I am amazed how so many so-called analysts have changed their tune. Bearish cheer leaders have suddenly become bullish.

I reiterate that Malaysian CPO production for 2010 will be less than in 2009 and will probably finish very close to my forecast of 17.2 million tonnes. **The model that I have used and refined over the last 30 years has always pointed the correct trend and I am very happy that its projection has been so accurate this year.** Let me clarify that the production shortfall is primarily due to the normal effect of the El Nino of 2009. Rainfall in terms of volume and distribution is critical for the Oil Palm and a big disturbance like an El Nino can be very disruptive.

The shortfall in CPO production would have been more noticeable but for the very liberal application of fertilisers and excellent estate management that we witnessed in the last 18 months as a result of rising prices. This factor will have an implication for CPO production in 2011 which I shall explain in my forthcoming papers later this year.

World Climate

Before I discuss the latest worldwide S&Ds for vegetable oil, let me say a few words about worldwide climate. In all my 35 years in this industry, I have never witnessed such a rapid transition from El Nino to La Nina as we saw in 2010. This almost back-to-back transition has caused several severe imbalances in world climate. I am not a weather man but I have to say that weather disturbances in the form of drought, wet springs, flooding and frosts have been more evident this year than any other year I can recall. This is the reason why Agricultural commodities are in the midst of one of their most bullish phases.

We have looming supply problems in Wheat, in Rice, in Corn, in Canola, in Sun seed and above all in Soybeans. The upcoming weather in South America is critically important for corn, wheat, sun seed and soybeans.

I would also like to say that I am very concerned by the regular volcanic activity we have seen during 2009 and 2010. There is a school of thought which explains climatic occurrences in terms of large masses of volcanic ash in the atmosphere. This is an area of great importance to those who trade agricultural commodities and we must be mindful of this factor.

Other reasons for the Boom in Agri Commodities

Aside from climate, a second reason for the boom in Agricultural commodities has been the economic growth in the developing world where populations are large and consumption levels have been relatively low. More than 3 billion people in the developing world are eating and living better. Foremost in this respect has been the remarkable growth in China. We have also seen a remarkable run of consumption of meal in China and this has epitomised the strength and vitality of China's economy. The single most significant event has been the boom in soybean imports by China. Meal consumption has grown remarkably in China in 2010. Meat and meal consumption are proxies for rising prosperity and therefore we must congratulate the Chinese economy on spreading prosperity to its large population. As more of the rural Chinese population becomes urban, I am tempted to say, the best is yet to come.

Third reason has been the weakness of the US Dollar.

The fourth reason has been the expansionist and growth promoting policies of central banks.

And the fifth is the large volume of fund investment in commodities.

In the past few weeks, agricultural commodities have developed a momentum based on tight fundamentals which seems sustainable even if the U S Dollar were to recover modestly.

The current oil year Oct 2009 to Sept 2010

In the space of vegetable oil, India has surprised most people by the strength of its consumption demand. When I made the forecast that India would import 9 million tonnes of vegetable oil this year, many experts disagreed. We can see the final outcome in a few days and we shall not only reach but exceed that forecast. Whilst China has relied on its domestic crush of imported oilseeds, India has relied on imports of palm and soya oils.

Let us first see how we are ending this oil current year Oct-Sept 2009-10 in terms of Incremental S&Ds

000 tonnes	**Oct 09 to Sept 10**
Soya oil	+ 2,200
Rape oil	+ 1,300
Sun oil	- 300
Gn oil	- 200
Cotton oil	- 200
Palm oil	+ 1,300
Lauric oils	+ 500
Total Increase	**+ 4,600**
Demand	**+ 6,000**

As I have explained in my previous papers, most of the growth in palm oil production came in the first 3 months of the Oil Year, particularly in October 2009. What is most remarkable is that the behaviour of prices almost exactly reflects the developing Incremental S&DS as the situation has got tighter and tighter.

Supply & Demand Outlook for the next 12 months

Let me now discuss the outlook for production and demand for specific oilseeds and oils for the next 12 months.

Soya: The world situation in soybeans is tighter with each day. We are in the midst of the South American growing season and we have yet to see the full effect of this year's La Nina. However, even with current estimates of 67 million tonnes of beans for Brazil and 52 million for Argentina, the World S&Ds are very tight. Any loss due to La Nina will make the S&Ds tighter.

There will be a big fight for acres in USA in 2011 and that is leading to steadily rising prices for beans. We also need to focus on the production of bio-diesel in the USA in the light of RFS2. **If that production picks up, the world supply of soya oil in the months of January to May 2011 will be the tightest we have seen in many years.**

There is some question about the export tax policy of the Argentine government in the light of the passing away of former President Nestor Kirchner. The market has been expecting export taxes to be reduced gradually but if that does not happen, farmers will agitate furiously. On the other hand if some reduction does happen, farmers will be better remunerated and they may release more selling in the month of January. That could lead to tightness later in the March to May period.

Up to now the presumption was that we have an ample cushion of old crop beans being carried forward into 2011 plus expectation of a big crop in USA triggered by high prices. We have been presuming an increase in worldwide crush by a further 10 to 12 million tonnes, giving us higher soya oil production of almost 2 million tonnes. **Events of the past 6 weeks must make us question that assumption. I am therefore reducing my projection of growth in soya oil to just 1.5 million tonnes next year**.

Rapeseed: The crop in Western Australia is a big disappointment and total Australian production has been considerably scaled down in recent weeks. China's Rapeseed crop is down this year and China has been importing rapeseed for crushing even at high prices. It appears that Rape oil demand in China is not price elastic at the current premium over soya oil. The S&Ds for Canola in Canada this year are very tight. Export demand for canola is very strong and the domestic Canadian crush is also strong with at least one new plant coming on stream. It remains to be seen how much canola will be available for carryover. In other words, Canola oil has room to rise in price if demand from Europe (for bio diesel) emerges. Worldwide Rapeseed crush must decline in 2011 and Rape oil production should decline by 1 million tonnes or even 1.2 million tonnes.

Sunflowerseed: The problems of the Ukraine and Russia are well known. We are not sure about the Argentine crop yet. However recent price action suggests extreme tightness. On the other hand, the high price premium of sunflower oil over soya oil and palm oil has already meant that Indian demand for sun oil has reduced dramatically. At current premiums, Indian imports of sun oil may reduce from 600,000 tonnes in 2009-10 to just 250,000 in 2010-2011. Thus we must watch the developing sun seed crop in Argentina very carefully and also keep an eye on demand rationing. It may be true to say that so far, sun oil is the only oil where we have seen significant demand contraction. The trouble is this is substitution and not rationing. Demand released from sun oil is immediately migrating to soya oil or to palm oil. I am at present estimating a drop of only 300,000 tonnes in sun oil production in this oil year.

Palm oil: My estimate is that world production of palm oil in calendar year 2010 will expand very little, about 300,000 tonnes. Growth will be Negative in Malaysia and mildly positive in Indonesia. I expect the biological cycle to turn Upwards from April 2011 onwards and that should be the beginning of strong growth in production. However, the slowdown in acreage expansion in Indonesia will mean that overall in 2011 we shall have growth in palm oil production of only about 2.5 million tonnes.

The days of heady expansion of palm oil production are definitely over. This will have profound implications for price behaviour and the world must be braced for much higher prices in the years to come. When people talk of a moratorium on further palm plantations, they are consigning mankind to higher and higher prices for the foreseeable future. Politicians are very quick to blame bio fuels for high prices of food and vegetable oil. Sadly they forget that restrictions on production and productivity like the ban on GM seeds or a moratorium on plantations have a much more bullish impact on price behaviour.

I shall refine my forecast of palm production in 2011 in my forthcoming papers, at Bali and later in Kuala Lumpur.

Lauric oils: Palm kernel oil production will expand but slightly less than its normal proportion to palm oil. This is due to the new clones which produce slightly smaller kernels and slightly greater mesocarp in the palm fruit. Coconut oil production will actually decline year on year in Philippines.

I expect the supply of **cottonseed oil and groundnut oil to be up a combined 0.5 million tonnes**.

Demand scenario

It now looks as though the dreaded Double Dip is not going to happen. The calendar year 2010 will end with average world growth in excess of 4 percent with a forecast of even better growth in 2011. Bio diesel mandates in several countries will continue to expand and so will growth in population and in per capita consumption in the developing world. However we are at very high levels in terms of price and hence we must estimate growth in world demand to be 4.5 to 5 million tonnes only for oil year 2010-2011.

Now we can see the developing Incremental S&Ds for next year

000 tonnes	**Oct 10 to Sept 11**
Soya oil	+ 1,800
Rape oil	- 1,000
Sun oil	- 300
Gn oil & Cotton oil	+ 500
Palm oil	+ 2,500
Lauric oils	-----
Total Increase	**+ 3,500**
Demand	**+ 4,500**

There is one caveat here. If the bio diesel subsidy is restored in USA or if RFS2 is implemented with retrospective effect, bio diesel demand will grow by 2 million tonnes and will be very bullish for U S soybean oil.

At present, it looks like for the third year in a row, Incremental Supply will not match Incremental Demand. You will also see that I have been extremely conservative in my estimates. And yet there is a mis-match between Incremental Supply and Incremental Demand of 1 million tonnes.

We must therefore begin to give up too many thoughts of any meaningful decline in vegetable oil prices during 2011, based on fundamentals alone.

Whilst palm production will recover, we shall encounter lower production of Soybeans and Sun seed in South America. Overall oilseed and oil production will not have a chance to recover strongly.

Why is the Scenario so bullish?

One reason is the wrong signals that were sent out by the market to consumers earlier this year. Bearish analysts and mis-guided producers kept pressing the market and the decline in prices seen in May and June 2010 led to stronger levels of consumption than what the world could afford. We are now paying for that splurge.

PRICE OUTLOOK

PALM – I believe CPO futures on the BMD will reach 3300 Ringgits in the next few weeks. However, I am afraid that level will not be sufficient to ration demand. The period of greatest tightness will be between February and May 2011 and we may require even higher prices in December and January to prepare the world for that tightness.

Soybean oil – Soya oil will also need to rise because too much incremental demand from sun oil and rape oil consumers will migrate in its direction. A level of between US$ 1200 and 1250 FOB Argentina is to be expected.

Sunflower oil will maintain a premium of about US$ 150 over soya oil prices.

I expect Rapeseed oil prices also to maintain premium of US$ 100 to 150 over soya oil.

Palm kernel oil has already touched US$ 1500 CIF Rotterdam and should advance further to take out the highs reached in 2008. The outlook is the same for Coconut oil.

Agricultural commodities need to command higher prices

I have long argued that farmers need to be remunerated better. Let me give you an example. When I started in commodities in December 1977, the first oil I traded was Canadian rapeseed oil. Canola was not born at that time. Canadian rapeseed oil was then US$ 500 per tonne FOB. Corn was then 2.28 a bushel. Gold was US$ 148 per troy ounce and crude oil was US$ 14 a barrel.

Exactly 23 years later, Corn and Rape oil have just about doubled in price. Crude oil is Up almost Six fold and Gold is up almost Ten- fold. If Rape oil were to reach US$ 1500 per tonne, it would still be 50 percent cheaper than crude oil in relative terms. Such is the catching up that agricultural commodities require.

What can negate the bullish forecast?

The threat of Contagion can scuttle this bullish forecast. If Equities tank, for any reason, then all commodity prices will also fall and will take vegetable oil, oilseeds and meal down as well. We are already at historically high levels. These high prices are the direct result of easy money and what is called Quantitative Easing. If anything were to happen to dampen this sentiment, markets will crash and commodity prices will fall. Prices will need to fall substantially to stimulate demand once again.

Conclusion

The Round Table on Sustainable Palm oil is meeting in Jakarta at present. Let us hope palm oil producers will take up my suggestion to provide consumers with Green Palm Oil at no extra cost. It will be the biggest leap in sustainable agriculture in recent decades and will transform the perception of palm oil in the western world.

So with those words, and with a pat on the back for the Dalian Commodity Exchange and Bursa Malaysia, I wish you all a very successful trading season.

My next paper will be on 3 December 2010 in Bali at the GAPKI conference.

Good Luck and God Bless

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