

Fundamental Approach to Price Forecasting – 2010

Paper by **Dorab E Mistry**
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Ladies and Gentlemen

I am delighted to address the delegates at **Globoil International** once again in **Dubai**. I congratulate **TEFLAS** and the **SEA** on the choice of Dubai and the success of the **Globoil Brand**. Unfortunately due to disruption caused by Volcanic Ash, I was stranded in Mumbai and have only just got back to London. Whilst I cannot join you in Dubai, I am very happy that I can speak to you via this telelink.

As usual, **I shall refer to my last paper at POC 2010** presented in Kuala Lumpur on 9th March 2010.

My prognosis so far

The key point of my POC paper was CPO production and the general recovery of the world economy. At the cost of repetition I have to remind you that as early as 4 December 2009, I have been voicing my concern about CPO production in 2010. I have been saying that for the first time in history, we shall see two consecutive years of production decline in Malaysia. My estimate of 9 March was for Malaysia to produce only about 17.2 million tonnes of CPO as compared with 17.556 mln mt in 2009 and 17.727 million tonnes in 2008.

I had further stated that Indonesian CPO production will rise only on account of expansion of mature acreage and that production will rise at best by 1million tonnes in 2010.

Events post KL POC 2010

Palm

The MPOB reported a big jump in March CPO production of almost 20 percent compared with the disappointing figure of February. This has raised hopes amongst many players that CPO production may be on a recovery path. My own research does not substantiate this hope. One month's production can be misleading and so far there is no reason to believe it will herald a general recovery in production. I believe the biological Cycle in Malaysia is playing out as expected and the High Cycle should end shortly. The full effect of the two droughts is yet to be felt. It is good that the current El Nino is coming to an end but that does not mean we shall not see any more of its effects. Typically the effect on production comes after a time lag and we are yet to see them. I expect more or less the same pattern to be repeated in Indonesia and therefore I am happy to confirm and repeat my earlier estimates of palm oil production in 2010.

Soybeans and Soybean oil

Developments post- POC on the soya front have been somewhat bearish. The Brazilian and Argentinean crops have turned out to be better than earlier estimates. Most price analysts went to the extent of predicting a fall in soybean prices with CBOT futures down to \$8.50 as a support. The term I heard most frequently was **This Tsunami of Beans!**

What has actually happened?

Soybean futures struggled initially but found South American farmers very reluctant to sell at low prices. Institutional investors appear to have shorted the market on the basis of bearish fundamentals and have had to come in and cover their losses. CBOT soybean futures at the time of writing have surpassed \$ 10. What is even more interesting is that Meal is the stronger part of the Crush and Corn and Wheat prices have also held firm.

Farmers in Argentina are clearly not happy with the government and are reluctant sellers of beans. They would like export taxes to be lowered or removed. This is simply not affordable by any government and so the current status quo is likely to last.

China has promulgated certain measures which could lead to restriction of soya oil imports over the next few months. These measures will help Brazilian and US soya oil exports but are likely to benefit Palm in particular. The domestic impact of this measure will be to improve crush margins in China and keep the import of soybeans by China at a record level. Yet, have we seen Argentinean soya oil prices collapse? Not at all. The most we have seen is Argentinean soya oil go to a small discount to the FOB price of RBD Olein and that has served as a bottom.

I am reminded of the English proverb **When one door shuts, another one opens**. India has stepped into the space created by very competitive Argentinean soya oil.

Planting intentions in the USA and the favourable outlook for plantings may hold out the promise of yet another big crop and a sharp increase in the carry-over. This factor is still too far out and we have the small matter of still planting and then growing the new crop.

INDIA

India is still nursing the wounds of a bad monsoon season in 2009 and oilseed production has been low. Yet, India is holding record stocks of oilseeds including soybeans and rapeseed. Indian farmers are angry and are refusing to sell at low prices.

India is no longer a subsistence economy where no stocks or low stocks are the norm. It is sign of India's rising prosperity and development that farmers can now choose when to sell and when to abstain. Let us also not forget that only a few years ago India held almost 40 million tonnes of food grains in stock? If the Indian government wants, it has the resources and the resolve to hold stocks and keep prices at a remunerative level.

I have always been ready to criticize and to applaud the Indian Government from time to time. **May I once again applaud the Indian Government on its wise decision to allow the unhindered export of oilseed meals.**

At this point, I am sure all of us in the Indian industry will want to send our thanks and our good wishes to one of India's most gifted administrators, **the Agriculture Secretary Mr T S Nand Kumar who has just retired. The Indian Agriculture minister Mr Pawar also deserves credit** for the admirable performance of his ministry in a year when the monsoon failed.

The strength of the Indian Rupee has been one of the bullish factors in the market and the same can be said for the Chinese Yuan and for the Brazilian Real. Translated in to domestic currencies, the price of vegetable oil is very reasonable and very affordable. Imported oils are able to out- compete domestically produced oils. That is why in domestic currency, oilseed prices in India are not attractive to farmers. The same applies in Brazil.

As local currencies keep getting stronger and local interest rates remain higher and Dollar interest rates remain at historic lows, it makes sense to import vegetable oil on extended trade credit. These financially inspired imports are becoming very popular in China, India and several other countries. As their currencies gain against the US Dollar and their local interest rates harden, this trade becomes more attractive. We shall call it the **Liquid Carry Trade**.

CHINA

Apart from the new development in China with regard to soybean oil imports there has not been any other significant change in China. The government continues to make noises about tightening credit and cooling the economy but the pace of growth and prosperity continues to be strong. The government has also come forward with higher guaranteed prices for oilseeds. The strength of the Yuan and the prospects for an upward revaluation make imports attractive.

Sunflower oil

The availability of sunflower oil from the Black Sea has improved in the last 6 weeks. It is possible that the Black Sea sunseed crops were under-estimated. The predicted bullishness in sunflower oil has not materialised and this may be considered a negative for price outlook for the next 8 weeks.

Rapeseed oil

The latest news from Canada points to higher plantings of new crop Canola.

The World Economy

The latest estimate from the IMF says that the world will grow at a very healthy 4.2 % in 2010. This estimate has been revised up from earlier 3.9 %. The **BRIC** countries like China, India, Brazil and Russia and indeed the Developing economies as a whole (which have the largest population and are the fastest expanding markets for vegetable oil) are expected to grow by 6.3 % whilst the Developed economies will grow by 2.3 %. It is salutary to remember that in 2009 the World Economy CONTRACTED by 0.6 %. As a matter of interest, the IMF is optimistic that in 2011, the World Economy will grow by another 4.3 %.

Therefore it will be fair to say that consumption of vegetable oil will grow at the pace we have been expecting. To some extent, this optimism on consumption balances the somewhat greater availability of supply.

Energy Prices

In the last 6 weeks, most of the larger investment banks have come out with forecasts for crude oil to trade in the range of \$ 90 to \$ 100 per barrel. We have also seen higher prices agreed for major commodities like iron ore and coal.

Anticipation of some good news and some bad news

The position on bio diesel mandates and bio diesel production has room for some good news for prices. The Blending Incentive of One Dollar per Gallon in USA has not yet been renewed for 2010 but its renewal is not in doubt. When that happens, perhaps during the month of May, it should give a boost to the usage of soybean oil for bio diesel with beneficial impact on Oil Share in USA.

The market is also awaiting some good news on enhanced usage of bio-diesel under the recently announced RFS2 Guidelines. Blenders are expected to step up usage in order to comply with the new mandates in the second half of the year.

If Energy prices hold or rise, the discretionary use of bio fuels will also expand, particularly in Europe.

Having discussed the new factors to have emerged post the POC in March 2010, let us now look at the Worldwide Incremental S&DS

I do not expect any increase in the soybean crush; over and above my estimate of 12 million tonnes extra crush.

The world's incremental S&Ds can be seen as follows

000 tonnes	Apr 09 to Mar 10	Apr 10 to Mar 11
Soya oil	- 1500	+ 2000
Rape oil	+ 1800	+ 1500
Sun oil	+ 2000	- 600
Gn oil	- 200	- 200
Cotton oil	- 200	- 200
Palm oil	+ 1500	+ 800
Lauric oils	+ 100	+ 200
Total Increase	+ 3500	+ 3300

In 2009-10, World Demand for food oil and bio fuels grew by 4.5 million tonnes in total. Let us remember that the World Economy did not grow at all and in fact contracted by 0.6 %

In 2010-11, with better than expected growth of 4.2 %, I am confident that World Demand for food oil will grow by 4 million tonnes and biofuel demand to grow by at least 2 million tonnes. Therefore, growth in Demand will once again exceed the growth in Supply.

Global Incremental S&Ds can be seen as follows

000 tonnes	Apr 09 to Mar 10	Apr 10 to Mar 11
Supply	+ 3,500	+ 3,300
Demand	+ 4,500	+ 6,000

PRICE OUTLOOK

The job of the market is to anticipate upcoming factors. For the past several weeks, the market has been fixated by the massive new supply of beans and of bean oil from South America. Side by side, there have also been reports of more availability of sunflower oil and of bigger plantings of rape and canola. Therefore it is not surprising that the market has been under some kind of pressure.

The problems of Greece and related expected problems from Portugal, Ireland and Spain have put the Euro under pressure and have sustained the strength of the U S Dollar.

In my Kuala Lumpur Price Outlook paper, I had correctly anticipated most of these developments. If you recall, I had expected the Dollar to begin to weaken only after June-July 2010. Besides, pressure from large supplies of bean oil from South America was also taken into account. Given such pressure, Palm oil prices have been trading sideways in a band of 2450 to 2600 Ringgits with a short visit to 2700.

The drawdown of Palm oil stocks in Malaysia has been quite dramatic. For the first quarter of 2010, Malaysian stocks have been drawn down a hefty 585,000 tonnes. Production has been 3.864 million tonnes, just a mere 74,000 tonnes more than the previous year. On the other hand, Exports have charged ahead year on year just as they have done every year for the last 2 decades. Exports at 4.149 million mt

are ahead by 288,000 mt. Mention must be made of Malaysia's extra-ordinary success in marketing palm oil and opening up new markets. Domestic use of palm oil in the Malaysian Oleochemicals and Soaps industry is also expanding year on year. Therefore, it seems realistic that some kind of rationing will be required in the Q3 and Q4 of 2010 if stocks are to be kept at a level of at least minimum comfort.

What developments will negate my forecasts?

First, a collapse in Energy prices. Second, a longer period of Dollar strength.

Third, a Trade War between China and the West leading to contraction in economic growth. Fourth, abolition of all export taxes in Argentina.

At present none of these appear to be probable but we must never discount the possibility of at least one of them happening.

I wish to make one more point before I speak on Price Outlook.

RSPO

Recently we have seen heated words and dramatic actions in the context of Sustainable Palm Oil. The excellent work done by the Round Table on Sustainable Palm Oil is threatened by what I call over-reaction and excessive action on the part of some people. The Palm Oil industry in Indonesia feels it is being targeted whilst NGOs feel their hard work and their efforts are being deliberately ignored by plantations. I cannot emphasize too strongly that the RSPO is the right forum and the only forum for these issues to be discussed and resolved. We must try and avoid unilateral actions that undermine the RSPO.

Price Outlook

I had expected Palm oil prices to gain on soft oils and this happened much sooner than was expected. RBD Palm Olein will trade at a slight premium to soybean oil and its usual discount will take a long time to re-appear. I am happy to confirm my Kuala Lumpur forecast that CPO futures on the BMD will have to rise substantially after June and will trade in a range of 2800 to 3200 Ringgits.

Developments on the production front have largely justified my concerns and I find that more and more analysts are tending to agree with me. **Whilst exports expand, production will lag behind that expansion. That is why I remain bullish on prices.**

Soybean oil will have to wait until after August to be able to rise. After August I expect soya oil FOB Argentina to rise from current levels of \$ 800 to about \$ 1000

I continue to remain bullish on lauric oils and expect Coconut oil to regain its premium over Palm Kernel oil later this year.

In conclusion, the stronger than expected growth in the world economy will cancel out the slightly better production prospects for oils other than palm. Every development since 9 March 2010 gives me confidence in my price forecast.

Good Luck and God Bless