

Palm Oil Fast Forward to Prominence

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Ladies and Gentlemen

I am delighted to be speaking on my favourite topic of **Palm oil** at this august forum after a gap of almost 5 years. I am grateful to the **NIOP** for making this possible and it is also a tribute to the remarkable promotional work done in North America by the **MPOC**.

As is well known by now, Palm Oil futures will soon be launched on 24 May by the CME in a Dollar denominated contract and this is likely to put palm oil trading within reach of thousands of investors and commodity market participants. It will de-mystify palm oil to players in North America and will make the market more liquid. Palm Oil is now by far the biggest vegetable oil in terms of absolute tonnage as well as in terms of world trade. Yet investors are wary about entering this market because of its size and liquidity. Palm Oil futures need to be more broad-based and available to a much bigger worldwide audience. This JV between BMD and CME will give it that platform.

Palm oil is increasingly popular in the USA and the rising volume of palm oil usage will be one of the major new developments of the decade.

Some background

The story of palm oil is fairly recent. I shall quote from statistics compiled by **Oil World publications of Hamburg**.

In 1976, out of world production of 17 Oils & Fats of 48 million tonnes, palm oil and its sister palm kernel oil (Pko) comprised just 3.5 mln mt or just 7.25 %

In 2008, world production of palm and Pko was 48mln mt out of total world production of almost 160 mln mt or a hefty 30.52 %

Over the same period, production of soya oil expanded from 9.6 mln mt in 1976 (20 %) to 36.8 mln mt in 2008 (23 %).

World consumption of all 17 Oils and Fats in 1976 was 47 mln mt and has expanded in 2008 to 160 mln mt.

World population has expanded from 4.14 billion in 1976 to 6.75 billion in 2008.

Per capita consumption has expanded from 11.42 kilos in 1976 to 23.69 kilos in 2008.

On the other hand, the average nominal price in U S Dollars of the 3 major vegetable oils has remained almost static. In real terms, prices have been falling by about 2.5 percent each year.

In one sentence, this growth in consumption has been possible due to the prodigious productivity and low cost base of palm oil.

Having seen these bare facts, let us also examine the reasons for the popularity of Palm, apart from its price.

Reasons for Palm's popularity

First, LOCATION: Palm has the advantage of being grown within 8 degrees north and south of the Equator. The principal producer countries are Malaysia and Indonesia and surrounding islands. This area also happens to be on the doorstep of major population concentrations in China, India, Pakistan, Bangladesh and the whole of South East Asia. Sailing time to most of its markets is just about a week and smaller ships of 6000 to 8000 tonnes have been used in most cases.

Second, High Quality Refined Products: The growth of palm oil production has been matched almost blow for blow by the development of an efficient refining and processing industry. Again the refining and processing industry has had 2 distinct features – it has either been integrated with larger plantation companies or it has been established by destination players, in other words by palm's export customers. That is how in the early days of the 1970s and 1980s, the refining industry included significant investment from Japan, India and Europe.

The palm oil refining and processing industry set new standards in low cost refining, thus ensuring that palm customers in many cases got used to importing high quality refined products like RBD Olein and RBD Stearine. Side by side with that, a large and bustling Oleo chemicals industry was developed. I believe this was a very important factor in the development and popularity of palm oil. Palm is unique in the large proportion of Refined and Processed, Value added products that are exported quite in contrast to soya oil or sun oil or rape oil which are largely exported in crude form. Even today, most price comparisons are made between the price of RBD Olein and Crude Degummed soybean oil. This at once puts palm at an advantage because the importer gets a Refined, readily saleable product. This emphasis on export of Refined Products has made palm extremely popular with smaller importers and traders who can very quickly and conveniently turn their purchase into cash.

Third, Lack of a large home market: The palm oil processing and shipping industry has been extremely flexible and hungry for business. By force most palm production has to be exported and this has made them extremely Consumer-oriented. If a smaller trader wishes to import some vegetable oil, he is almost certainly going to import palm products. The palm industry has not undergone the type of consolidation that the soft oil industry has undergone.

Fourth, the oil itself: Palm oil has some very attractive characteristics. The Refined product is colourless and odourless and can be made into margarine or Vanaspati very easily. It has a problem with its melting point but most of its markets are in the tropical areas. Above all it does not have the problem of Trans fatty acids.

Fifth, No complementary product to dispose of: Palm is almost unique in that it does not have a complementary product like meal as in the case of other oilseeds.

And finally, its greatest asset has been its low cost base: Palm originates in low cost countries. Coupled with its extraordinary productivity, it has an unbeatable advantage on cost. I believe Palm has become the Oil of Choice for the developing world on account of its low cost base.

For example, In Malaysia 1 hectare of plantation land produces 4.5 tonnes of palm oil plus another 0.54 tonnes of Pko. In all over 5 tonnes of oil per ha.

In USA, 1 hectare produces 2.67 mt beans or 0.31 mt of soya oil.

Outlook for Palm in the future

With recent inflation and higher commodity prices, 2 questions arise.

Will the production of palm oil keep expanding at the same rate as in the last 10 years?

And will its price remain at current levels?

Let us first look at the phenomenal growth in consumption and production of Oils and Fats in the last 9 years.

World Consumption expanded from 113 mln mt in 2000 to 160 mln mt in 2008.

Per capita consumption grew from 18.72 kilos in 2000 to 23.69 kilos in 2008.

It will be seen that the Supply of Palm oil and PKO expanded dramatically in the years 2000 to 2005 from 24.5 mln mt to almost 38 mln mt or by 13.5 mln mt over 5 years which works out to about 2.7 mln mt per year.

Between 2005 and 2008, the Palm complex supply expanded even more rapidly from 38 mln mt to 50 mln mt or 12 mln mt which comes to almost 4 mln mt per year.

The period 2000 to 2008 also happened to see great expansion of cultivation of oilseeds in major areas like Canada, the Ukraine and Russia and most importantly in Brazil and Argentina.

Therefore World Production of 17 Oils & Fats grew from 115 mln mt in 2000 to 160 mln mt in 2008. **Of the 45 mln mt increase in production in 8 years, palm family contributed as much as 25.83 mln mt or 57 %**

Can this growth be sustained?

Last week at the **Palm Oil Price Outlook conference in Kuala Lumpur**, I made a prognosis on Incremental Supply and Incremental Demand for the 12 months April 2010 to March 2011. I display the table below

Global Incremental Supply

000 tonnes	Apr 09 to Mar 10	Apr 10 to Mar 11
Soya oil	- 1500	+ 2000
Rape oil	+ 1800	+ 1300
Sun oil	+ 2000	- 1000
Gn oil	- 200	- 200
Cotton oil	- 200	- 200
Palm oil	+ 1500	+ 800
Lauric oils	+ 100	+ 200
Total Increase	+ 3500	+ 2900

What you will notice is the fact that the contribution of Palm oil to Incremental Supply is a mere 1.5 million tonnes in the previous year but more alarmingly, it is less than 1 million tonnes for the forthcoming year.

I believe this a measure of great concern to all of us.

The reasons for this deceleration in the rate of expansion of Palm oil production are several. Chiefly, the expansion of acreage in Malaysia is now almost over. Production in Malaysia can be expanded by improvement in productivity only. A tremendous amount of work has been undertaken in this respect and some improvement will be seen in the next few years. However a quantum leap in productivity may have to wait for several years.

In Indonesia, most of the increase in production came from expansion of acreage. This breakneck expansion is now coming to an end. Availability of suitable land and the pressure from NGOs are two reasons for this. Expansion of acreage used to be around 500,000 ha per year in the period after 1997. From 2008 it appears that this rate of expansion has slowed down to a more measured 250,000 ha per annum. In Indonesia too, the scope for increase in productivity is large because almost 30 to 40 percent of planters are small holders. However it is a big task to get small holders to embrace new technology and improve productivity.

My prognosis is that we shall have to look to higher prices in the future to attract acreage to oilseeds and to palm and that consumers will have to get used to paying higher prices.

Ags have got left behind

I believe Oilseeds and grains have been left behind in comparison with metals or energy.

Whereas in 1970, a bushel of corn could be bought with one barrel of crude oil, in 2008 you could buy 27 bu of corn with that same barrel of oil.

Again, in 1970 an ounce of gold at \$ 35 could buy about 20 bu of corn. In 2009 that same ounce of gold could buy 256 bu of corn.

So either Ags have got too cheap or Energies and Metals have got too expensive.

One reason for the lower price of Ags and in particular of vegetable oils is the almost total absence of investment money in these markets. According to a recent report for Barclays Capital, the total value of Commodity Assets Under Management as at the end of 2009 stood at US \$ 257 Billion. The bulk of this amount lay invested in Energies and in Gold, in Base Metals and in Precious Metals. A very small percentage was invested in Ags and of that, the only products that got a look in were those that were either Exchange Traded or were fungible and had well regulated futures markets.

This is why the tie up between the BMD and the CME is so important. The Dollar denominated Palm oil contract, traded on the Globex platform has the possibility to develop significant volumes and to attract investment flows.

Bio fuels will help prices

I believe the price of Ags must rise. This fits in neatly with my theory that the price of vegetable oils will have to rise. The link with Energy in the form of Bio diesel will help that process. **Bio fuels are a bridge between low priced Ags and high priced Energies.**

Western agencies have been extremely tough with Palm oil when evaluating for incentives normally offered to bio fuels. There is a feeling amongst palm producers that some discrimination exists against Palm. My view is that it does not matter if palm is eligible for subsidies or not. So long as Soya oil and Rape oil are used increasingly as bio fuels, that creates space for greater use of palm oil and thus palm oil benefits indirectly from greater production of bio fuels.

The Future for Palm oil trading

Apart from BMD which has a contract denominated in Malaysian ringgits, there is the very successful Dalian commodity Exchange which has a Yuan denominated contract.

There have been attempts to establish a Palm oil ETF in Singapore but these attempts have so far not been successful. One reason is the extreme reluctance of plantations to commit to selling large quantities of physical palm oil several months forward. Second the product is likely to deteriorate as time goes by so it would have to be physically renewed every few weeks. And thirdly, the cost of storage and financing would be considerable. Yet it is not inconceivable that someone will come up with an ETF at some stage. The easier option will be to invest in the CME's Dollar denominated contract once it develops liquidity.

Will the growth in per capita consumption continue at the current pace?

I believe it will continue for the foreseeable future. The first reason is population growth. We are adding 80 million new mouths each year. Secondly, the big population countries like China, India, Bangladesh, Pakistan and Indonesia have low per capita consumption rates as compared to developed countries. On the other hand their economies are growing fast and living standards of their populations, almost 3 billion people in all, are rising fast. That factor is likely to keep consumption growing at the current pace.

In the past, consumption was artificially held down by countries like China and India by imposing high and punitive import taxes on vegetable oil imports. The entry of China and of India into the WTO has led to the dismantling of such high import taxes and import quotas. This has lowered the price and led to fast growth in consumption. The most recent example is India which abolished all import taxes on unrefined vegetable oil in late 2007. This led to a massive growth in per capita consumption of almost 13 percent or some 2 million tonnes.

If consumption keeps growing at the current rate, how will production keep pace?

The answer lies in remunerative prices. This means average prices will have to rise and make farming and plantations attractive. I believe it can be done. The growth in palm oil production can be accelerated once again by relying on productivity growth. As palm production becomes more remunerative, more re-planting of hybrids will be undertaken, more estate managers will be better trained and incentivised and better and more sustainable agronomic practices will be adopted.

One great advantage for all stakeholders sitting together in the **Round Table on Sustainable Palm oil** is that it concentrates minds to find the best way forward, minimising the use of new fresh hectares and raising productivity in a sustainable manner.

Palm oil was a native of Africa and it is on that continent that some of the most exciting developments will take place in the next few years.

For the moment we have the small matter of getting through the current year with relatively tight Palm oil supplies. As my table of Incremental S&Ds shows

Global Incremental S&Ds

000 tonnes	Apr 09 to Mar 10	Apr 10 to Mar 11
Supply	+ 3,500	+ 2,900
Demand	+ 4,500	+ 6000

Not everyone subscribes to my figures and I am open to correction. When I first raised an alarm on palm oil production prospects for 2010 about 4 months ago, my warnings were largely over-looked.

Last week in Kuala Lumpur I made some price forecasts. The gist of these is that the world supply situation gets very tight in the last half of 2010 and prices must rise. Right now huge soya crops in South America are likely to make people complacent. Therefore I shall simply repeat in brief my price prognosis.

I am presuming that Crude oil prices will be trading in the range of US\$ 70 to 95 for most of the year. I believe the palm market has a comfortable cushion of stocks for the next few months and this will be helped further by large soybean oil supplies coming out of South America. For the period March to July 2010 I expect RBD Olein to trade in the range of \$ 800 to 900 FOB Malaysia

Post July I expect RBD Olein to trade higher and exceed \$ 1000 FOB

I expect **Lauric oils** to outpace Palm because this El Nino appears to be affecting Philippines more severely. I expect Coconut Oil in Rotterdam to regain its premium over Palm Kernel oil and to trade initially at around USD 1000 cif Rotterdam and then to gradually rise to US\$ 1300.

The spread between Crude Palm Oil and Soya oil will remain very narrow in 2010 and briefly it is possible for Palm oil to go to a premium.

CONCLUSION

Palm oil will continue to expand its footprint in North America and indeed all over the world. However, consumers will have to pay higher prices to ensure sufficient expansion of supply.

We are on the verge of some exciting times in the trading of palm oil as the new Dollar denominated contract makes its debut on the CME Globex platform. When I accepted the invitation of NIOP to speak at this Annual Meeting, I was not aware that the timing would be so fortuitous. I thank you for your attention and wish you great success and good trading in the coming months.

My next Price Outlook paper will be in Dubai at Globoil International on 25 April.

Good Luck and God Bless