

Palm Oil Price Outlook 2009

With special reference to India

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Ladies and Gentlemen

At the outset I wish to thank **Bursa Malaysia** for inviting me and I thank you all for participating in what is clearly the Biggest Vegetable Oil Conference in the world.

Let me start with a humble admission. My forecast at this conference last year was far too optimistic and was soon over-taken by events. The market did go within a whisker of my forecast of 4500 Ringgits just 4 days after the words left my lips. Yet, in my heart I know I got it wrong. I had expected major investment and speculative fund activity in commodity markets to continue for the foreseeable future. This was not to be the case. As hot money exited our markets, all commodities from Crude oil to metals and oilseeds began a swift descent. After my speech in Jakarta on 23rd May, I too became bearish as I saw growing evidence of **Demand Destruction** as a result of high prices. As the outlook for world economic growth diminished, this Demand Destruction gathered pace and we saw big drops in the market in the months of August and September. Welcome relief came in the month of December and that has set the scene for this conference.

Lessons to be learnt

Equities, commodities and the macro economy are inter-twined and we shall have to discuss all three. **The greatest importance this year goes not to Fundamentals but to the Macro Economy.**

With the benefit of hindsight, I was far too optimistic about the macro economic situation in the world in 2007 and early 2008. I had placed great faith in the ability of Central Bankers to fine tune monetary policy to keep the growth engine of the world ticking along at a brisk pace. As many of you recall, I have been a great admirer of Messrs Greenspan and Bernanke. My reasoning was that in this day and age, with information available so fast and several leading indicators available to guide central bankers, it would be possible to take action to prevent contagion. I was wrong in my optimism.

The events of the past 12 months have proved that the tried and tested Laws of Economics will eventually prevail. They have given us 2 important lessons:

Countries must live within their means. You cannot run a thriving economy indefinitely on the Never-Never. Deficits must be paid for, either in the form of taxation or by contracting the economy;

And Second, Bubbles do happen and ultimately they must burst.

When the Bubble bursts, the economy must suffer contraction and the result is quite painful for the majority of consumers. There is one more lesson to be taken but I shall revert to it when I speak on Price Outlook.

The problem of Non-performance and Default

In many ways, the extra-ordinary events of 2008 brought us face to face with the curse of our markets – Non performance and Default. This brings me to my **Annual Pat on the Back** or Award for outstanding performance in the previous year. There were many in contention, particularly those companies which read the market exceedingly well. However, **this year I wish to applaud** (and I urge all of you to join me in applauding) **the guts and the courage of a small band of Indonesian Palm oil companies who Stood Up against the curse of this market – the Defaulter.** I do not need to name them but everyone knows who they are and they deserve kudos by the spade. They said **Enough is Enough** and exposed their Defaulting Customers. Sadly, many of the culprits turned out to be my fellow Indians and worst of all were Indian Public Sector companies.

We have all known and applauded India's economic strength in recent years. It is therefore a great pity that in 2008, the Indian government, by virtue of its ownership of these public sector companies, earned

the **Dubious Title of the Largest Defaulter in Agricultural commodities**. Defaults stretched from vegetable oils to pulses. To be fair, there were defaulters in China, in Pakistan, in Bangladesh, in Russia, in Ukraine, in Eastern Europe and even some so-called Blue chip companies in Western Europe. There are also many honourable Indian companies which always stand by their obligations.

The Indian public sector company defaults are in a category of their own. **Their behaviour was nothing short of scandalous.**

Whilst others rushed in to gather whatever scraps of business they could, a handful of courageous Indonesian companies came together and published a Blacklist of Defaulters through their Association GAPKI.

The Indian press played a very commendable role in exposing the Defaults. India's seniormost commodity editor personally wrote several times on this infamous subject. So far, the Indian government has not shown any desire to tackle this problem. It is a pity. These public sector companies must be made to honour their obligations. It will do India's image as a great trading nation a tonne of good. The government could start by calling a meeting of the affected palm oil companies and hear at first hand, from the horses' mouth, the extent of the admitted and un-admitted Defaults.

Speaking of contract performance, the events of 2008 have given a whole new meaning to **Counter Party Risk**. There is I am told an unwritten formula amongst palm oil traders who do business with counter – parties in the Indian sub-continent, in Iran, in the Middle East or in China or in Ukraine or in Russia.

When a customer refers to you as **His Friend** – you know he is good for 400 Dollars Price Difference;
 When he calls you **His Dear Friend** – you know he is good for 200 Dollars Price Difference;
 When he calls you **His Brother** – you know you are in trouble even if the Price Difference is 100 Dollars.

With such Brotherly affection over-flowing in our markets, I am afraid Counter Party Risk must remain paramount in 2009 and 2010 also. Many companies have become very weak and their bankers are unlikely to be of much help to them.

Having got this off my chest, I shall now discuss the Indian scenario. The tables below give my estimate of India's production of vegetable oils for the oil year November to October. As usual these have been prepared with latest information provided by my friend Mr Govindbhai Patel and the Solvent Extractor's Association.

Let us first look at India's production of vegetable oil.

(Oil year November to October)

INDIA'S PRODUCTION

000 tonnes	2008-09	2007-08	2006-07	2005-06	2004-05
	Estimates	Estimates	Actual	Actual	Actual
Soybean oil	1200	1445	1280	1140	900
Cotton oil	900	1050	920	755	660
Gn oil	700	900	580	950	970
Sun oil	500	550	580	620	470
Rape oil	1800	1700	2150	2250	1570
Sesame oil	150	150	120	125	200
Coconut oil	390	380	380	400	400
RiceBranoil	740	720	680	660	610
Others	250	250	225	200	200
Total	6630	7145	6915	7100	5980

The economic scenario in India is deteriorating day by day. My observation is that the worldwide recession or slowdown or mini depression came to India a bit late. If the US and UK were first into recession, then Eastern and Western Europe went in next followed by China and South East Asia. India was probably last.

In fact in the initial months, in the third quarter of 2008, India probably benefitted from the worldwide slowdown because energy prices fell (India is very affected by high energy prices being a massive importer), interest rates were reduced and credit was liberalised. However, from November 2008, particularly since 26/11 the Indian economy has been suffering and growth rates have fallen dramatically.

The forthcoming General Elections in India are likely to be inconclusive and will not give a clear cut mandate to any coalition or block. I am afraid the best guess today is for a repeat of the period 1996 to 1998 when India had 3 Prime Ministers within 2 years and governments changed each year. During periods of such political instability, the economy suffers because expediency, corruption and sloth gain the upper hand. My prognosis for the Indian economy and for India's economic growth rate is not encouraging. India's manufacturing sector must be expected to contract in the next few months and overall growth rate may decline to around 3 percent. A slowing economy will definitely affect vegetable oil consumption and imports in the months from now until the end of the year.

Therefore I am forecasting that vegetable oil imports into India from now will slow down from the hectic pace we saw between November and February. Import duty on palm products is unlikely to be imposed or increased until a new government is in office and that means not until the end of June. My forecasts of consumption and imports are based on this rather uncertain economic scenario.

In 2008-09 India's per capita consumption will increase primarily as a result of low prices due to duty-free imports of CPO and lower all round import duties. India will also be one of the very few countries whose vegetable oil imports will actually increase year on year.

Let us now look at INDIA'S CONSUMPTION

000tonnes	2008-09	2007-08	2006-07	2005-06	2004-05
	Estimates	Estimates	Actual	Actual	Actual
Soybean oil	2000	2100	2550	2850	2700
Cotton oil	900	1000	900	720	660
Gn oil	650	880	580	1020	950
Sun oil	850	580	780	680	500
Rape oil	1750	1650	2150	2250	1420
Sesame oil	150	150	120	160	200
Palm oil	5660	5090	3925	3150	3436
Laurics	600	600	600	450	450
RiceBranoil	740	720	680	650	600
Others	200	225	225	350	350
Total	13500	12995	12510	12280	11366
Pop.Mlns	1160	1140	1120	1100	1080
Per cap kg	11.64	11.40	11.17	11.16	10.52

We can now study INDIA'S S&Ds

000 tonnes

INDIA'S S&D for	2005-06	2006-07	2007-08	2008-09
Opening Stock	750	850	750	1025
Production	7,100	6,915	7,145	6630
Imports	5,400	5,615	6,300	7145
Consumption	12,280	12,510	12,995	13500
Exports	100	120	175	100
Ending Stocks	850	750	1025	1200

INDIA'S IMPORTS of Vegetable Oil

000 tonnes	2008-09	2007-08	2006-07	2005-06	2004-05
Soya	900	750	1335	1770	2027
Palm	5595	5270	3665	3000	3169
Sun	400	30	200	90	5
Laurics	200	200	200	240	145
Vanaspati	50	50	215	300	200
Total	7145	6300	5615	5400	5546

Having discussed India I now turn to the Global Scenario

GLOBAL SCENARIO

The news coming out each day is much worse than any of us expected. I am sure very few of us expected the industrial output of major countries to fall or collapse by 20 to 30 percent as is the case at present. The stimulus packages are at best softening the blow somewhat. It also appears fairly certain that contraction of economies will continue until at least the end of calendar year 2009. As I said earlier, China

and India entered the slowdown fairly late but even these BRIC countries are now witnessing contraction in demand.

I have long contended that the poorer parts of the world did exceptionally well out of the commodity boom. Today, with commodity prices having fallen, these developing countries are badly off. We have seen anecdote after anecdote of Demand Destruction in the developing countries of Africa, Asia and the Middle East.

Therefore, we must pay attention this year to Demand rather than to Supply.

Let us first look at the state of various oilseeds

Soya: The demise of the La Nina phenomenon has given us a big improvement in Argentina and we are likely to harvest a soybean crop of about 43 million tonnes. The Brazilian crop is likely to exceed expectations and may now be close to 58 or 59 million tonnes. What is more important is that Argentina starts the season with carried forward stocks in excess of 6 million tonnes. There is also the tantalising possibility of a large increase in soybean acreage in USA later this year. The only bullish factor remaining is the questionable nature and perceived stupidity of the Argentine government. No folly is beyond the capability of the government in Buenos Aires. For that reason, we must be cautious in our bearishness in soya.

On the other hand, weakening exchange rates for the Real and Peso augur well for further expansion of acreage in both Brazil as well as Argentina in the next year. There is also a great amount of mid proteins in the world and that will affect the demand for soya meal. Meat consumption is also falling given the difficulties of consumers in most countries. The recent sharp decline of the Mexican Peso also works against soya demand. Therefore, overall in the case of soya, bearish factors outnumber the single bullish one.

Rapeseed: The Canola crop in Canada and the Rapeseed crop in Australia turned out to be bigger than even the most optimistic estimates. The current Rapeseed crop in China is also bigger than last year and reliable estimates are as high as 12 million tonnes. Yet China has imported record tonnages of Rapeseed so far this year. It seems that the big Rapeseed crop in China will be bought by the Government as a price support measure and held in storage. At some stage later in the year, these stocks will have to be recycled and released into the market, thus prolonging the agony. The Rape Mustard crop in India is also likely to be significantly larger this year, close to 6.4 million tonnes. On the other hand, demand for Rape Biodiesel is muted in Europe. The planting intentions for 2009 in Canada for Canola are also surveyed to be higher than the record plantings of the previous year. Therefore in Rapeseed too, there are more bearish than bullish factors

Sunflower seed: The Argentine sunseed crop is now estimated to be less than 3 million tonnes. We are also approaching the end of the season in Ukraine and Russia. Therefore Sunseed presents one of the few bright spots in the market. However, I must caution you that the massive devaluation of currencies in Ukraine and Russia has made their agricultural exports very profitable and this will accentuate the export of whatever they can ship out, as quickly as possible. Therefore even this bright spot is somewhat dimmed.

Palm oil: My friends in the plantations tell me that Malaysian CPO production in 2009 will at best equal that of 2008 and may even be a bit lower. They also advise that production will be more skewed in favour of the Second Half of the year. We are likely to see a tightening of stocks in Malaysia during the first half.

Indonesian CPO production is expected to expand by about 1.5 million tonnes due to larger acreage. Palm has enjoyed 2 big advantages in these last few months. Firstly, palm prices were super competitive, having been over USD 200 cheaper than soya oil for most of 2008. Secondly, the principal markets for palm, namely India and China are the only economies still enjoying growth. Therefore we must expect palm exports to continue to do well in recent months. **I fully expect the price of RBD Olein to come very close and temporarily to exceed the price of Crude degummed soya oil.** Palm is doing so well on exports that palm will need to push demand away towards soya oil and that will be done by Price.

Therefore, we can summarize **Global Incremental Supply** as follows

000 tonnes	Oct 07 to Sept 08	Oct 08 to Sept 09
Soya oil	+ 1200	
Rape oil	+ 500	+ 1400
Sun oil	- 1000	+ 1500
Gn oil	+ 200	----
Cotton oil	-----	-----
Palm oil	+ 4500	+ 1500
Lauric oils	+ 450	+ 300
Total Increase	+ 5850	+ 4700

The Big Question we must ask ourselves is Can Food Demand for vegetable oils expand in 2008-09 by the usual 4 to 5 million tonnes ?

As my analysis on India demonstrated, Indian consumption will expand by half a million tonnes. However, this is due to low prices caused by the abolition of import duty on CPO and crude sun and rape oil and very low import duties on other oils. This is a very unusual situation. Elsewhere in the world, particularly in Eastern Europe, in Ukraine, in Africa and even in Western Europe we shall see more frugal behaviour. Waste will be eliminated and consumers will be more careful in their spending habits. This must lead to stagnant or even lower per capita consumption.

People must realise that the current economic crisis in Europe and elsewhere is already about a year old. Countries have already suffered 2 or more quarters of a shrinking economy. Unemployment is rapidly rising. Consumers have become exceedingly careful and have battened down the hatches. Therefore, this time is like no other that my generation has seen. Consumption patterns will not go back to those of the Great Depression years but the scenario is much more serious than we have seen in any recession since the 1970s. Let us pause for a moment and consider if there was ever such a situation when almost every country in the world suffered from slower or negative growth.

The IMF is severely behind the curve and has been hopelessly optimistic in its estimates of overall world growth in 2009. Yet even the IMF has now conceded that in 2009, the world as a whole will record a small fall in production and a "dramatic" collapse in trade.

My estimate is that World consumption of Vegetable Oil as food will expand only by 2 million tonnes at best. A lot will depend on how bad and how ugly things get over the next few months. So far in 2009 the economic news has been grim and things are likely to keep getting worse.

One observation I can offer after reading a part of the history of the years 1929 to 1933 is the unfailingly regularity with which some Big Unexpected Bad News kept coming up to foul up and destroy expectations. I am afraid we must brace ourselves for such occurrences over the next several quarters.

On Bio diesel my estimate is that overall world demand for vegetable oil for bio fuels will be stable. We shall lose demand in some markets and gain in some. At best, if crude oil prices climb to US\$ 50 to 60 per barrel, world Bio diesel demand may expand by 500,000 tonnes in 2008-09.

To summarize the world Incremental Supply and Demand

For **2007-08**, Total Demand grew by just over 4.5 million tonnes. Food demand grew by about 3 million mt and Bio fuel demand by about 1.5 million mt. Food demand grew less than expected due to very high prices. Supply grew by almost 6 million tonnes.

For **2008-09**, I expect food demand to grow by just 2 million tonnes. Bio fuel demand should grow at best by 500,000 tonnes.

Thus the **Global Incremental S&Ds** can be seen as

000 tonnes	Oct 07 to Sept 08	Oct 08 to Sept 09
Supply	+ 5,850	+ 4,700
Demand	+ 4,500	+ 2500

For the second successive year, world incremental production will comfortably exceed world incremental demand. We can see quite clearly that supply exceeds demand not because supply is higher but because we expect demand to grow more slowly.

There is one other major bearish factor which will have a profound effect on price outlook in the months from April onwards. That is the prospective increase in soybean plantings in the USA later this year. Given the additional acres to be released from CRP this year, we are likely to see an increase in soybean plantings and this is expected to lead to a burdensome carryover.

Weather?

The S&Ds and the prospective increase in US stocks must lead us to believe that the world, after a gap of several years can actually afford a weather problem.

RSPO

Green Palm Oil certificates are now widely available and the entire process is a great credit to our industry. All of us from plantations to shippers to consumers can feel justifiably proud of the progress made by the Round Table on Sustainable Palm Oil.

However let us not forget that mankind's need for vegetable oil is almost insatiable as living standards rise. Palm is the only oil capable to meeting that demand and of keeping prices affordable. Those who live in the West and whose forefathers polluted the world so much, need to remember this. One of the greatest polluters today is Air Travel. Despite that, people in western countries are showing no inclination whatsoever of avoiding air travel and taking to sailing ships. Yet they are all too keen to ask Indonesians to travel on top of elephants!

The RSPO is a sound compromise to accommodate the many justifiable concerns of the West with the equally justified aspirations of the East. The leaders of the RSPO deserve our support and our admiration.

PRICE OUTLOOK

My normal presumption is that the U S Dollar will remain reasonably strong for the next several months.

I must also point to the absence of that very significant factor which was in evidence in our markets last year. **The massive participation of investment funds in our futures markets is no more.** As I had explained in my paper last year, Index funds exerted a huge influence in commodity markets by immobilising supply. Trend following funds exacerbated the situation by creating new liquid demand. Together they brought huge power to the bulls and managed to create an illusion of scarcity. Price is a function of money, demand and supply. The amount of money simply overwhelmed supply and exaggerated demand. This crucial factor is now much less in evidence in our markets. We must reckon with more humble times as a result.

As I have said earlier, palm oil stocks for the next few months will tighten and this is likely to help palm oil prices. I expect BMD CPO futures over the next few weeks to cross 2000 Ringgits and they may even briefly challenge 2100.

The High Cycle in palm oil lasted much longer than I had anticipated. I am told that the newer younger palms are less prone to this biological cycle and need only a brief few months of rest and recuperation. The better performance of palm oil prices since December has also lead to good use once again of fertiliser. Therefore I am estimating that from August onwards we shall see a very good uptick in CPO production. That is why I am afraid my prognosis is that BMD futures will only get to 2100 Ringgits at best.

Beyond April and May, palm will become uncompetitive against South American soya oil and will lose market share.

For the second half of the year, I expect palm oil CPO prices to come under pressure both from soya oil and also from bigger production and weaker demand. My range for CPO prices from now until October is 2100 to 1500 Ringgits.

In U S Dollar terms, RBD Olein is likely to go down and challenge US\$ 500 FOB or lower.

Currencies of most developing countries are weakening and the Dollar is winning the Ugly Sister contest hands down. Weakness of the Indonesian Rupiah is a danger to palm oil prices.

Let us not forget that we live in deeply troubled times. In previous bear markets CPO has traded down to much lower levels.

I expect **Lauric oils** to follow palm downwards. Demand for oleochemicals is closely allied to economic activity and recessions are never good for oleochemicals. We are already seeing activity at only 70 percent of normal and this will be reflected in lower prices for lauric oils.

I expect **Crude Degummed Soya oil** to trade down to US\$ 500 FOB Argentina. Again, in previous recessions it has traded much lower and I will not be surprised to see it fall further.

Both Brazil and Argentina are commodity linked economies. Therefore their currencies are weakening against the US Dollar. For that reason soya oil at USD 500 FOB or Chicago Bean futures at US\$ 7 per bushel may not be such a bad price translated into local currency in the next few months.

When I read and re-read this paper and pondered over my price forecasts, I did not get the feeling that I was forecasting for a period which is likely to be the bleakest since the Great Depression. Major and Cruel Bear Markets have a tendency to make us feel that the worst is almost over and that recovery is just round the corner. **The most cruel bear markets are marked by some of the most promising rallies.** It is not for nothing that traders say "there is nothing as dangerous as a Bear Trap". People generally survive the first big decline in most bear markets. It is the Killer Rallies that destroy most. I offer you these words of caution.

World trade is shrinking and credit availability is scarce. Output is falling, prices are falling and there is a very real threat of Deflation. In these troubled times, it may be instructive to read the history of the years 1929 to 1933.

The Third Lesson

And now I come to the third important lesson of the laws of Economics. **Currencies of Debtor nations must decline once the special factors have been exhausted.**

Therefore at some stage, perhaps later in 2009 or in 2010, the US Dollar must fall. If and when that happens, we shall all have to scramble to buy commodities and become devotees of that **great investment Guru Mr Jim Rogers.**

I am not here to speculate when that might happen but at some stage it will surely happen. As they say, **the seeds of the next Bull Market are laid in the morass of the last Bear Market.**

CONCLUSION

After having described what I see as a very depressing outlook for the world economy and by extension for vegetable oil prices, I leave on a more optimistic note. Caution has to be the watch word. I wish you all great success and good trading in the coming months.

Good Luck and God Bless

(My thanks as usual to my friend Alex Wells, the Walking Matrix, for his help at all times)