Palm current and forward

Price Outlook

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Ladies and Gentlemen

I am delighted to be speaking in the beautiful city of Istanbul under the auspices of the **Malaysian Palm Oil Council**. This region extending from the North African shores of the Mediterranean Sea, across the Middle East and right up to the CIS countries, is likely to emerge as a major area for consumption of vegetable oil. Living standards are rising, population is growing, economies are expanding and prosperity is spreading. All these factors make this region an ideal ground for the expansion of palm oil. As usual the wise leadership of the Malaysian Palm Oil Council has set to work on this potentially huge market at the right time.

In my paper today, I shall first trace the recent movements in world vegetable oil prices, explain why these happened and draw some conclusions that will assist us in understanding where markets are headed in the next few months.

Recent market developments

As you all know, vegetable oil prices staged an impressive rally in the 2 months from mid March to mid May. The major reasons for this rally were:

Firstly, the severe Drought in Argentina which reduced its soybean crop from 47 million tonnes to 32 million tonnes.

Secondly, The USDA report of 31st March 2009 on Planting Intentions for new crop soybeans in 2009 which gave us an estimate of just 76 million acres against previous trade estimates as high as 80 to 81 million acres.

Thirdly and perhaps most importantly, Indian imports and consumption of vegetable oil soared dramatically as a result of duty free imports and consequent low prices. Low prices spurred per capita consumption in this quintessentially Price Elastic market. It is now acknowledged that Indian per capita consumption has undergone a once-in-a lifetime upward adjustment of almost 1.4 kilos per head, as a result of the removal of import duty.

Fourthly, the lean biological cycle for palm oil production extended until April 2009 and that meant production during the first 4 months of 2009 was unusually low in Malaysia as well as Indonesia. We finally saw the Biological High Cycle kick in from May onwards. In the meantime, palm oil stocks were too low for comfort and prices had to rise to control demand. **Finally, we have not seen any significant demand destruction** except perhaps to some extent in Mexico and in parts of Eastern Europe. It was expected that demand for bio diesel would collapse. That has not happened. As a result of mandates, both existing and new ones, bio diesel production in 2009 will be somewhat higher than in the previous year.

Let me now talk specifically about Palm : Let us look at Supply Prospects.
CPO has started a powerful recovery in Malaysia and Indonesia from May onwards. At present, my best estimate of 2009 Malaysian CPO production is 17.73 million tonnes, about unchanged from the previous year. In the case of Indonesia also, my estimate of 2009 CPO production is still 21.5 million tonnes.

Low Stocks - It is my view that based on annual usage in terms of domestic consumption and exports of almost 19 million tonnes, a stock level of 1.4 million tonnes is a must for the Malaysian palm oil industry to operate normally. We must remember that for the palm oil processing industry, this stock level of 1.4 million tonnes represents 25 days consumption and includes Raw Material and Finished Goods combined. It is very tight. **Since the end of February 2009, palm oil stocks in Malaysia have been below this threshold and I expect them to remain below this threshold of 1.4 million tonnes until mid August.**

It was based on this tight stock-to-usage ratio, the general expectation of a recovery in the world economy, the looming drought in India and the developing El Nino phenomenon that I made a forecast on 18 May that CPO futures would climb to 3000 Ringgits. That forecast has not verified as yet. I would like to make a few comments on the price scenario post 18 May 2009.

Around mid May, we saw in circulation a number of forecasts of CPO production in the Second Half of 2009 in Indonesia and Malaysia combined. One particular set of figures made the market extremely nervous and I re-produce it here :

000 tonnes	**Jan –Dec 09**	**FH 2009**	**SH 2009**	**Increase**
Malaysia	17,843	7,993	9,850	**1,857**
Indonesia	20,870	9,445	11,425	**1,980**
Total	38,713	17,438	21,275	**3,857**
Per month				**640**

In other words, these statistics painted a picture that in each month in the Second Half of 2009, from July to December, the world would have to absorb an additional 640,000 tonnes of CPO.

Was the sell-off justified?

I believe figures such as this one, sent several analysts and traders into panic mode. Almost universally, with just one honourable exception (and he is truly a Gold plated analyst despite his young age), analysts who work for investment banks and brokerages became Bearish. The Wire Services (I normally have a lot of respect for their journalists) also got swayed by such statistics and also started writing very bearish stories. There were stories of tank-bursting stocks in India and of vessels waiting in the Middle East. This created a massive sell off in our markets and prices retracted all the way down from 2800 ringgits to almost 2000 ringgits. In my humble opinion this sell off was not justified by the then prevailing fundamentals. **Some pressure in the market in September was reasonable but to sell the market in June was absurd.**

I also wish to comment on the new breed of trader or investor we are seeing in our markets these days. Many of these worthies would have great difficulty distinguishing Stearine from Olein. Their knowledge of the product and the industry can be written on a single clean sheet of paper and their experience can be counted on one finger. They usually respond to news as they read it and learn of it (usually for the first time) from the news wires. We saw a classic display of this when the market dropped on the day news was reported that Indonesian Export Tax on CPO would be NIL in August. Almost every experienced physical trader knew it and had discounted it for 3 weeks. Yet on the day it was actually reported, the innocent and the unwashed sold the market!

However, at the end of the day, the market is always right and we have to adjust our stance to suit the majority of its participants. So we all have to be careful When to trade in addition to knowing How to trade. Sometimes, we may have traded some factor too soon. I believe in my earlier price forecast, I may have factored in the El Nino and the Indian drought too early.

Palm oil stocks

I would like to come back to palm oil stocks in Malaysia which are a key factor in price making. I believe stocks will replenish from mid August only. Based on information available at present and the outlook for exports, I expect Malaysian palm oil stocks to expand from the end of August and peak in November at around 1.8 million tonnes.

Having discussed PALM S&Ds in detail, I shall now speak briefly on the other major vegetable oils.

Sunflower oil: The availability of Sunflower oil in the Second Half of 2009 will get tighter. The massive amount of under-priced Black Sea sunflower oil which was available between December and March is a thing of the past. From early 2010, I expect Sunflower oil to command a significant premium to soya oil. This is also the considered opinion of my friends at **Oil World** – a publication that I have read and studied with great respect over the last 30 years.

Rapeseed oil: Rapeseed production is turning out to be better than expected in most parts of the world. We must however bear in mind that the threat of frost damage in Canada should not be overlooked in the next several weeks. The fate of the Indian Rapeseed crop, which is planted in December and harvested in March is still uncertain. Usually in El Nino years, when the Kharif crop (harvested in November) in India fails, the Rabi crop (harvested in March) does very well. However, this will depend on late season rains in September and how much India's reservoirs are filled. On the other hand, the elimination of Splash & Dash has given the European bio diesel industry a new lease of life and revived demand for Rapeseed oil. Therefore, Rape oil will remain a premium oil and command a premium to soya oil.

That brings me to **Soya oil**. As a result of the shortfall in South American crops in 2009 and the strong demand for beans from China, current world stocks of soybeans are extremely tight. Recent trading in Chicago soybean futures bears this out.

My friend **Anne Frick, senior oilseed analyst at Prudential Bache** has recently prepared an excellent table of Potential Supply of Soybeans as on 1st September 2009. I take the liberty of summarising it thus;

1st September 09 Stocks - 000 tonnes	2008	2009
Argentina	25,084	17,465
Brazil	24,546	17,106
Total including USA	**55,209**	**37,785**
Add U S crop (2009 est.)	80,536	89,595
Potential Supply on 1st September	**131,198**	**122,930**

From this table it can be seen that actual physical stocks of beans are lower this year by almost 18 million tonnes. It gives an idea just how tight the situation will be in South America with regard to soybeans and their products – meal and oil. It will translate to extremely strong export demand for beans and meal in USA during the period September 09 to February 2010.

Let us now look at DEMAND

On the DEMAND side, we must expect the new higher level of per capita consumption in India to continue at least until for the foreseeable future. India will continue to import between 650,000 and 700,000 tonnes per month until October 2010. That would give us a total for imports for the oil year November 2008 to October 2009 of at least 8.5 million tonnes. The newly elected government in India has not levied any additional import taxes on vegetable oils. The developing drought situation makes it extremely unlikely that any new import taxes will be imposed until November 2009.

As a matter of interest and to counter the extreme bearish picture of palm that was being earlier circulated, I am repeating my earlier prognosis of the break-up of imported oils into INDIA.

000 tonnes	**2008-09**	**2007-08**	**2006-07**
Soya oil	1000,000	750,000	1335,000
Palm	6750,000	5270,000	3665,000
Sun oil	500,000	30,000	200,000
Lauric oils	200,000	200,000	200,000
Vanaspati	50,000	50,000	215,000
Total	**8500,000**	**6300,000**	**5615,000**

Before I discuss the Incremental S&Ds of the world, let me caution you that Swine Flu is something that I have not taken into account in this analysis. I pray to God that Swine flu will soon be controlled and will not hurt humanity.

Global Incremental S&Ds

I have also not altered my forecast of Global Incremental Supply and Demand except for adjusting the figure of Palm.

We see clearly that Incremental Demand exceeds Incremental Supply in 2008-09. However, in terms of time scale, the first half of the year saw an increase in supply of sun oil and Rape oil whilst Palm oil supply actually contracted. Now in the Second Half, Palm oil supply will accelerate. The greater volume of palm will be required to satisfy the bigger demand in the second half coming from the festival season in India, from Ramzan demand and the acute tightness in soya.

We can see the Global Incremental Supply and Demand as follows :

000 tonnes	**2007-08**	**2008-09**
Soya oil	+ 1200	_ 1500
Rape oil	+ 500	+ 1400
Sun oil	_ 1000	+ 1500
Palm oil	+ 4500	+ 1500
Lauric oils	+ 450	+ 200
Total Supply	**+ 5650**	**+ 3100**
Demand	**+ 4500**	**+ 4500**

PRICE OUTLOOK

As I have said previously, the sell-off in June was not justified by the fundamentals. **Palm oil prices are rallying and I expect them to trade in a range between 2100 and 2300 Ringgits for the next few weeks.** There is no reason for prices to decline because stocks are still tight. The inverse in the price of RBD Olein says it all. If and when stocks begin to expand, possibly in September, prices will gradually decline and may test 2000 Ringgits. Should prices decline, it will be a buying opportunity.

A lot will depend on the cross rate between the US Dollar and the Rupiah and also the cross rate between the US Dollar and the Ringgit. Strength in the Rupiah will be constructive for Ringgit prices.

We shall also need to watch developments on the El Nino front. The latest information suggests we are due to have a mild El Nino. If that is the case, CPO production will suffer in the first half of 2010. The periods of dry weather in Indonesia and Malaysia will begin to make sentiment quite bullish from October-November onwards. **Depending on the strength of the El Nino, the rally tends to start around August if it is severe and around October-November if it is mild.** An El Nino inspired rally would come on the back of extremely tight soybean upplies. Since the El Nino itself is still developing it will not be wise for me to make a price forecast for that period yet.

Indian Monsoon Rains

As regards the failure of the Kharif Indian monsoon, I shall speak in more detail at **my next paper which will be on 27 September at Globoil India in Mumbai.** However, I must caution those who are getting a bit carried away by the current drought in India. We must remember that India only produces between 3.5 and 4 million tonnes of vegetable oil from its Kharif season crops. In this estimate I am including Rice Bran oil. **The combined production of vegetable oil from soybeans and groundnut is less than 2 million tonnes on average. Even if these crops are very badly affected and production declines 20 percent, it will only mean a shortfall of 400,000 tonnes.** In the overall context this is not a big deal. If prices of food grains, vegetables and staples rise as a result of the drought, India's famous Price Elastic Demand will take care of the shortfall and India may not need to increase vegetable oil imports by much.

Sentiment in the domestic market in India today is red hot. It is not justified. Indian traders are indulging in what Mr Greenspan would have called " irrational exuberance ".We now live in an open market and world supplies of vegetable oil are ample to take care of the shortfall in India. The bigger problem for India is the inability of its importers to bring in adequate supply of Pulses. These imports are chiefly undertaken by public sector companies. If you recall, these public sector companies were the biggest Defaulters in 2008 when prices collapsed. There is an old truth "As you sow, so you reap". The crisis in the importation of Pulses, and the consequent sky high prices paid by the hapless Indian consumer are the direct result of earlier Defaults by Indian public sector companies.

Finally, two other factors will play a role in price making.

CHINA: China will remain a large but enigmatic factor in the market. So far, the actions of the Chinese government in ensuring high domestic price levels to help local farmers have benefitted the world price level. It is probable that such supportive action will continue over the next several months and will continue to benefit world prices. **Secondly, the behaviour of the world economy** and the timing of the recovery will play an important role. At some stage in late 2009, the economies of the Developed World will begin to grow again. The psychological impact of that turnaround could be to the benefit of prices.

Conclusion

To sum up therefore, I believe Palm oil prices do not need to fall in the next few weeks and may in fact rally. If and when Stocks expand, prices will decline but 2000 Ringgits will be a very strong support. Prices at such a level are more of a Buy than a Sell. And finally, once the period of peak production and stocks has passed, prices can resume their recovery. This year the Weather Gods are all important. I shall comment on the market each month from now, firstly in Mumbai at Globoil, then in Capetown at AFROIL, then in Guangzhou at CIOC and finally in Bali at GAPKI.

I once again thank the **Malaysian Palm Oil Council** for inviting me to speak at this POTS conference in Istanbul.

Good Luck and God Bless