

# Market Outlook for Palm Oil with special reference to Sustainability & Bio Fuels

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Ladies and Gentlemen

I am delighted to address the **2<sup>nd</sup> RSPO Latin America conference in Belem**. My company **GODREJ** is a strong proponent of Sustainable Agriculture and has always supported the cause of fauna and flora. Therefore we are delighted to participate in this landmark extension of the RSPO to Latin America. The Palm Oil industry has come a long way towards improving its practices and to embracing Sustainability in a whole hearted and committed manner. The last 12 months have seen unprecedented success for **Green Palm Oil** or Palm Oil grown in a sustainable manner. My task today is to highlight the benefits of this enlightened self interest whereby the cost and effort of growing Palm Oil in a sustainable manner is made worthwhile with commercial success.

## **The rise of Sustainability is bullish for palm oil**

I am better known in the industry as an analyst of Palm Oil Price Behaviour and may I say at the outset that my paper today will not disappoint those of you who are looking forward to my more usual Price Outlook speech. I had planned to combine in this paper a discussion on the market opportunities for Sustainable Palm Oil with a discussion on Price Outlook for the next few months.

The rise of the Sustainability Movement is entirely justified and not before time. Many of us unreservedly applaud the work that NGOs have undertaken and welcome the spirit of Partnership that the RSPO has fostered between Consumers and Growers. One direct consequence of this Partnership is the greater attention being paid in Indonesia, Malaysia, Papua New Guinea, and even here in Latin America to selection of land for new plantations. This process of land selection has slowed down the expansion of plantation areas from an annual growth of almost 600,000 hectares at peak to about 250,000 hectares today. **This slowdown in growth has profound implications of future world supply of Palm Oil in particular and of vegetable oils overall.** I shall speak briefly on this aspect also.

Let me first cover the developments so far this year since my paper at the Palm Oil Price Outlook Conference (POC) in Kuala Lumpur on 9 March 2010.

## **Market Developments so far**

Many of you will recall that as early as 4 December 2009 at the Gapki conference in Bali, I sounded the alarm on prospects for CPO production in 2010. I explained this more fully in my POC paper in March this year and forecast 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.

My CPO production estimates were ridiculed and ignored by most commentators who were churning out wildly optimistic estimates for Malaysia with figures like 18.1 and 18.6 million tonnes. Most commentators

were relying on a continuation of big growth in Indonesia and were blandly predicting annual growth in world CPO production of 2 to 2.5 million tonnes. Even as recently as June, most commentators were happily predicting each month, a 10 to 15 percent growth in CPO production month-on-month.

As a consequence of very bad outside markets and the over-optimistic projections of CPO growth, CPO prices on the Bursa Malaysia Derivative fell from around 2600 Ringgits to a low point of 2250 Ringgits between April and June. From July onwards some sanity has begun to prevail as month after month, our so-called experts were proved wrong and CPO production failed to expand.

### **All 3 predictions have come good**

I am very pleased that all 3 of my forecasts are coming right. Firstly, the El Nino of 2009 is impacting the production of palm trees in 2010, just as I had predicted.

Secondly, my pain-staking research on the biological cycle of the palm tree, studied in conjunction with regional patterns over several sub-divisions in the Malaysia-Indonesia belt has once again proved to be correct. This cycle has so far been proved right at each juncture and that fact alone gives me much satisfaction. Research is hard work and time consuming.

I consider myself very fortunate to be part of **the remarkable Godrej organisation** where the motto has always been **Excellence with Integrity**. I have the opportunity to indulge in my passion for research no matter how much time and effort it takes and to speak my mind honestly and fearlessly. I believe the biological cycle, studied in conjunction with key variables like rainfall, temperature and fertiliser sales, gives the most accurate signal of CPO production performance.

Thirdly, my forecast that the U S Dollar must begin to weaken from July onwards also proved to be accurate almost to the day.

As a result we have seen a strong catch-up rally in world vegetable oil prices and particularly in palm oil prices.

At this juncture, I wish to reiterate that I stand by my forecast of Malaysian CPO production in 2010 at 17.2 million tonnes. CPO production during the Ramadan period will be flat to lower and recovery will have to wait until October.

**Indonesian CPO production has also disappointed and I feel compelled to reduce my forecast of growth to just 500,000 tonnes for 2010. Hence overall, for 2010, I am now forecasting Zero Growth in world palm oil production.**

### **Market Outlook for SUSTAINABLE PALM**

In my opinion our aim should be for all Palm oil produced in every corner of the world to be Sustainable Palm Oil. Sustainability is not an option anymore. The plantation sector needs to embrace sustainable practices whole-heartedly and to get its production duly certified.

It is a matter of great satisfaction to note that within less than 7 years of the formation of the RSPO, we have built up a capacity for 2.5 million tonnes of Sustainable Palm Oil and of this almost 1 million tonnes has been taken up by consumers. The trading platform for GREEN PALM OIL is working well and that is reflected in the declining premium expected by growers.

### **I have 2 suggestions to offer:**

**My first suggestion is that once we get to a Sustainable Palm Oil capacity of 5 million tonnes, suppliers should offer to supply Sustainable Palm Oil at a nominal or token premium of just USD 1 per tonne.**

In the last 2 months, palm oil prices have moved higher by over USD 100 per tonne and are currently in the region of USD 850 pmt locally. At this price level, the production of palm oil is quite rewarding to the growers and there is no need to charge a further premium for Sustainable Palm Oil. This will be the

quickest way for the industry to put its money where its mouth is and to convert the world to Sustainable Palm Oil. Let the industry not wait for its customers to come forward and demand Green Palm Oil. **Let each customer have no reason whatsoever to refuse to use Green Palm Oil.** I believe this is enlightened self interest and it will be the biggest positive statement made by the plantation sector in recent years. This single act will expand the market for palm oil and destroy all negative perceptions about palm oil cultivation.

Today, in the developed world, the single biggest hurdle faced by palm oil is the negative connotation associated with palm oil cultivation. This negative connotation prevents its full and unrestricted use in bio fuels and also in many applications and also in direct human consumption. As a result palm oil constantly sells at a discount to other vegetable oils. I believe a wholesale switch to supplying Sustainable Palm Oil will go a long way towards removing or at least narrowing this discount. In that way, the industry is likely to gain much more than the 7 or 8 Dollars of Green Palm Oil premium that it will forego.

**My second suggestion is for governments in major consuming countries like China and India to encourage the consumption of Sustainable Palm Oil by means of tax policy.**

The instrument of tax policy can be easily used to achieve this end. Here I applaud the initiative and suggestion made in India by Indian palm oil consumers who have come together under what is called the Hindustan Unilever Coalition and embraced a suggestion made by Godrej that import duty on palm oil should differentiate between Sustainable and other Palm Oil. A one percent concession to Sustainable Palm oil or a one percent additional levy on other Palm Oil will strongly incentivise the switch to Sustainable Palm Oil in India which is Palm oil's biggest single market.

In my humble opinion, the market outlook for Sustainable Palm Oil should be no different from the market outlook for All Palm Oil. And that market outlook for the next few years is extremely bright.

### **Forward Market Outlook**

We have seen over the years that we are adding about 80 million more mouths to world population each year. On top of that the three Billion people who live in the Developing World (comprising China, India, Bangladesh, Pakistan and the rest of Asia, Middle East and Africa) are eating better and living better each year. Therefore, world consumption of vegetable oils must expand at about 6 million tonnes each year on average. The bulk of this extra 6 million tonnes each year must come from the palm complex. Seed oils, particularly Sunflower and Rapeseed cannot win new and greater acreage year after year. We need a quantum leap in yields to boost production and such a breakthrough is not visible on the horizon yet. Soybean production can be expanded if prices are high enough but we all know that soybean is not an oil seed but a meal seed. Therefore the onus falls on the palm complex.

### **Bio diesel market outlook**

One must be very optimistic of bio diesel demand in USA as a result of the recent RFS2 regime. With or without incentives, the implementation of RFS2 will increase the consumption of soya oil for bio diesel and thereby create opportunities for palm oil. It does not matter if palm oil is used for bio diesel or if other oils are so used. Any vegetable oil going for bio diesel creates additional space for palm oil. Therefore it no longer matters if palm oil is treated as being eligible for bio fuel incentives.

Bio fuels are extremely important. They reduce green house gas emissions and they also support agriculture. For too long the farmers of the world have been given the wooden spoon. Agriculture is the least preferred vocation in the developing countries. The price of minerals, metals and of energy has galloped ahead but the price of agricultural commodities has got left behind. Bio fuels are the bridge that connect Agriculture to Energy and will create conditions to lift millions of small farmers from the trap of lifelong poverty. Sustainability should not just mean a clean environment for the developed world. True sustainability means a decent life for all people, particularly in the developing world. As we all know, **there is no greater pollutant than poverty.** That is why bio fuels and green energy must be welcomed. My estimate is that demand for vegetable oils for bio fuel will expand at the rate of 2 million tonnes per year for the foreseeable future. The remarkable vision shown by President Lula in Brazil and more recently by the governments of Argentina and Colombia must be applauded.

## Current Price Outlook

Let me now move on to the Price Outlook for palm and related oils over the next few months. As you know my method involves calculation of Incremental Supply & Incremental Demand.

I had said all along that I expected the soybean crush this year to expand by just 12 million tonnes despite the larger soybean crops in South America. At the time, people doubted my estimate and asked why the soybean crush in South America could not be expanded more. Recent events have proved my estimate to be quite accurate.

However some big changes have taken place in the supply of Rape oil, Sunflower oil and Palm oil since March this year. The adverse weather seen in Russia, Ukraine, parts of Europe and earlier in Canada has shrunk the size of oilseed crops.

**Rapeseed** production has been revised downwards and the rapeseed oil supply will only expand by at best 1 million tonnes. Most of this expansion has already taken place in the first 5 months of the year. From now onwards, there will be almost no expansion in Rape oil supply over the previous year.

In the case of **Sunflower oil**, I had under-estimated production. Supply of Sun oil was much more abundant in the first 5 months of the year and therefore, overall for the full year, Supply will only shrink by 300,000 tonnes. This figure will depend on the current on- going crop progress in Russia and Ukraine. If more crop damage is seen, farmers will hold back Sunseed and the crush will suffer.

As I have already said, I expect overall no growth in Palm oil supply and also in Lauric oil supply. In fact, lauric oil supply has been more plentiful in the first 5 months and will now shrink in the remaining months.

### The world's revised incremental Supply can be seen as follows

000 tonnes	Apr 09 to Mar 10	Apr 10 to Mar 11
Soya oil	- 1500	+ 2000
Rape oil	+ 1800	+ 1000
Sun oil	+ 2000	- 300
Gn oil	- 200	- 200
Cotton oil	200	200
Palm oil	+ 1500	+ -
Lauric oils	+ 100	+ -
<b>Total Increase</b>	<b>+ 3500</b>	<b>+ 2300</b>

Global Incremental S&Ds can be seen as follows

000 tonnes	Apr 09 to Mar 10	Apr 10 to Mar 11
Supply	+ 3,500	+ 2,300
Demand	+ 4,500	+ 6,000

We must remember that the major importing countries like China and India are growing rapidly and almost 3 billion people in the developing world are experiencing a fair wind of prosperity. As we can see,

world consumption will grow by 6 million tonnes this year – 4 million for food use and 2 million tonnes for bio fuel use.

We cannot draw down stocks so dramatically once again this year. So prices must rise in order to curb or reduce additional demand.

At current levels of price, ie US\$ 1000 CNF China or India for crude degummed soya oil or US\$ 950 CNF China or India for RBD Palm Olein, we are not going to ration demand and bring down growth in world demand to just 3 million tonnes.

For example, we have been projecting Indian consumption to rise by about 400,000 tonnes this year. If that happens, Indian imports will need to expand from 8.6 million tonnes to 9 million tonnes. My argument is that the world cannot supply that additional tonnage to India at current prices without starving someone else or dramatically reducing stocks. **Demand rationing must happen particularly in a price sensitive market like India.** My view is that domestic Indian prices must rise above Rupees 50,000 in wholesale for RBD Olein and for Refined soya oil for some kind of rationing to happen. Based on that hypothesis, if we are to curtail Indian imports by about 40 to 50,000 tonnes a month, prices of CPO must rise further and trade around 3000 Ringgits.

These calculations are never very water tight and therefore I have no hesitation in repeating my price forecast that CPO on the BMD futures will need to trade close to 3000 Ringgits and then perhaps even climb above that target depending on how production shapes and the world economy performs. The IMF forecast of world GDP growth of 4.6 percent in 2010 may be revised downwards slightly but it is still a very healthy growth rate and must lead to strong demand in the second half of the year.

Soybean oil has weathered all bearish factors very impressively and crept up to its current level of US\$ 910 FOB Argentina. In March I had predicted that Soybean oil will rise from US\$ 800 to FOB to about \$ 1000. I believe soybean oil will need to rise to US\$1050 FOB Argentina and will maintain a healthy premium over palm oil.

I believe Rape oil and Sunflower oil will remain the premium oils of choice in Europe and will rise closer to US\$ 1200.

The most bullish outlook now is with Lauric oils. World production of Lauric oils will show no growth at all this year. During the Second Half of this year, production and supply will be lower than the previous year. Coconut oil price level of US\$ 1300 and beyond is not inconceivable.

### **What can spoil the party for vegetable oil prices?**

The greatest threat to vegetable oil prices comes from Outside Markets. If Equities tank, for any reason, then all commodity prices will also fall and will take vegetable oil and oilseed down as well. We must therefore trade with caution and keep a sharp eye on what stock markets are doing. The world economy is growing once again but that growth is very lop sided with the developed world still not out of the woods. Contagion is the biggest threat to our markets.

### **Conclusion**

We are in the midst of a developing La Nina phenomenon. That factor will give us some very interesting developments on the weather front. The choppy nature of world stock markets, the performance of the US Dollar, the stability of the PIGS in the EU and the fragile nature of the growth profile of the developed world as a whole are variables that will affect demand. We are in for some very exciting times. On balance I believe prospects for vegetable oil prices are very bright for the coming months. This is a great opportunity for all of us to expand the availability and demand for certified Sustainable Palm oil. I wish you all good luck and happy trading for a more sustainable future.

**Good Luck and God Bless**