

# complex

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will start by describing one of the most surprising changes in the behaviour of the world vegetable oil market, which has occurred within the past five years.

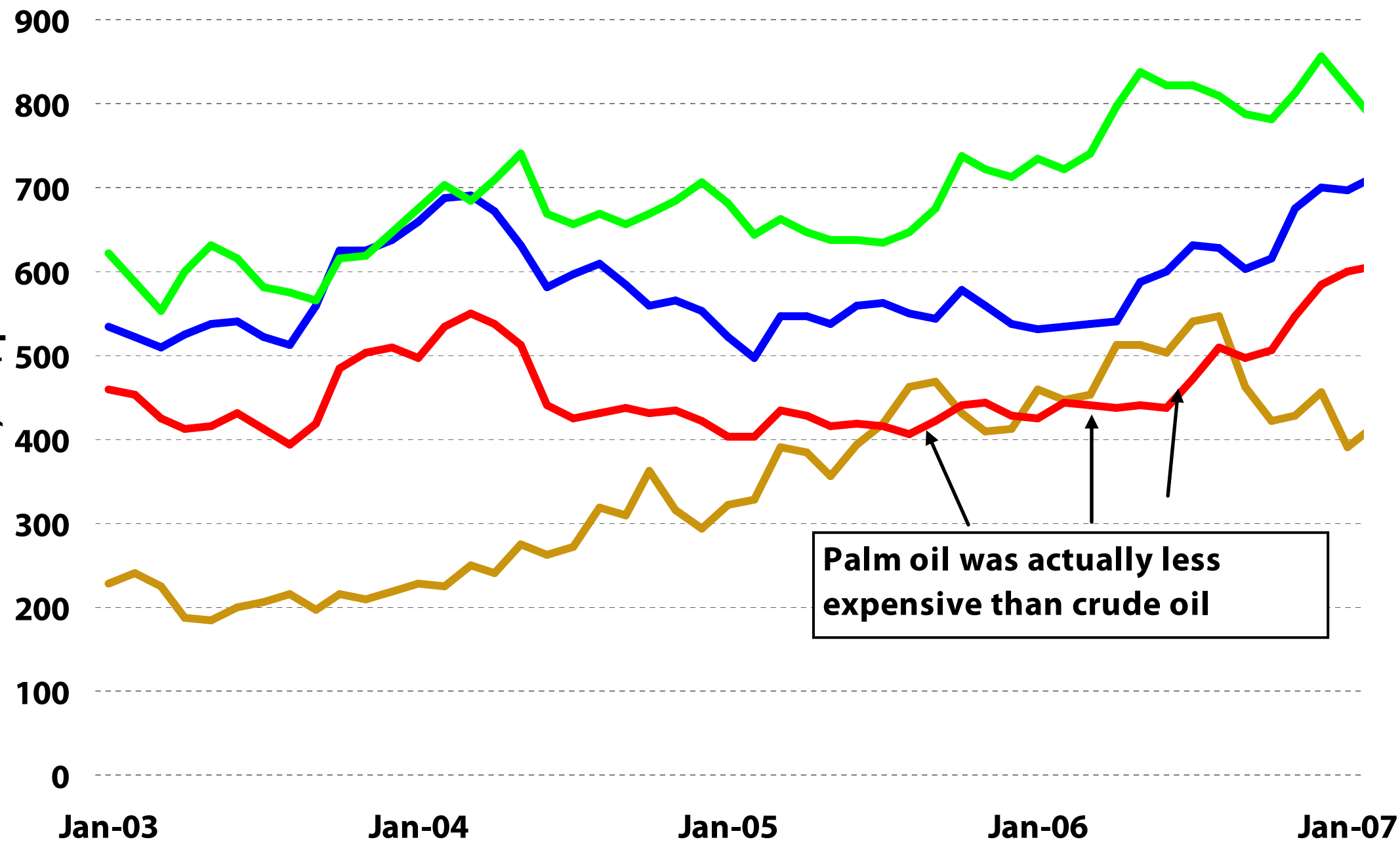
This is the way in which vegetable oils have become part of the petroleum complex, as regards pricing. I will explain why and how this has happened.

This has far-reaching consequences for the future behaviour of vegetable oil prices. In particular, while supply-demand balances do matter, they are less important than they used to be in setting oils prices.

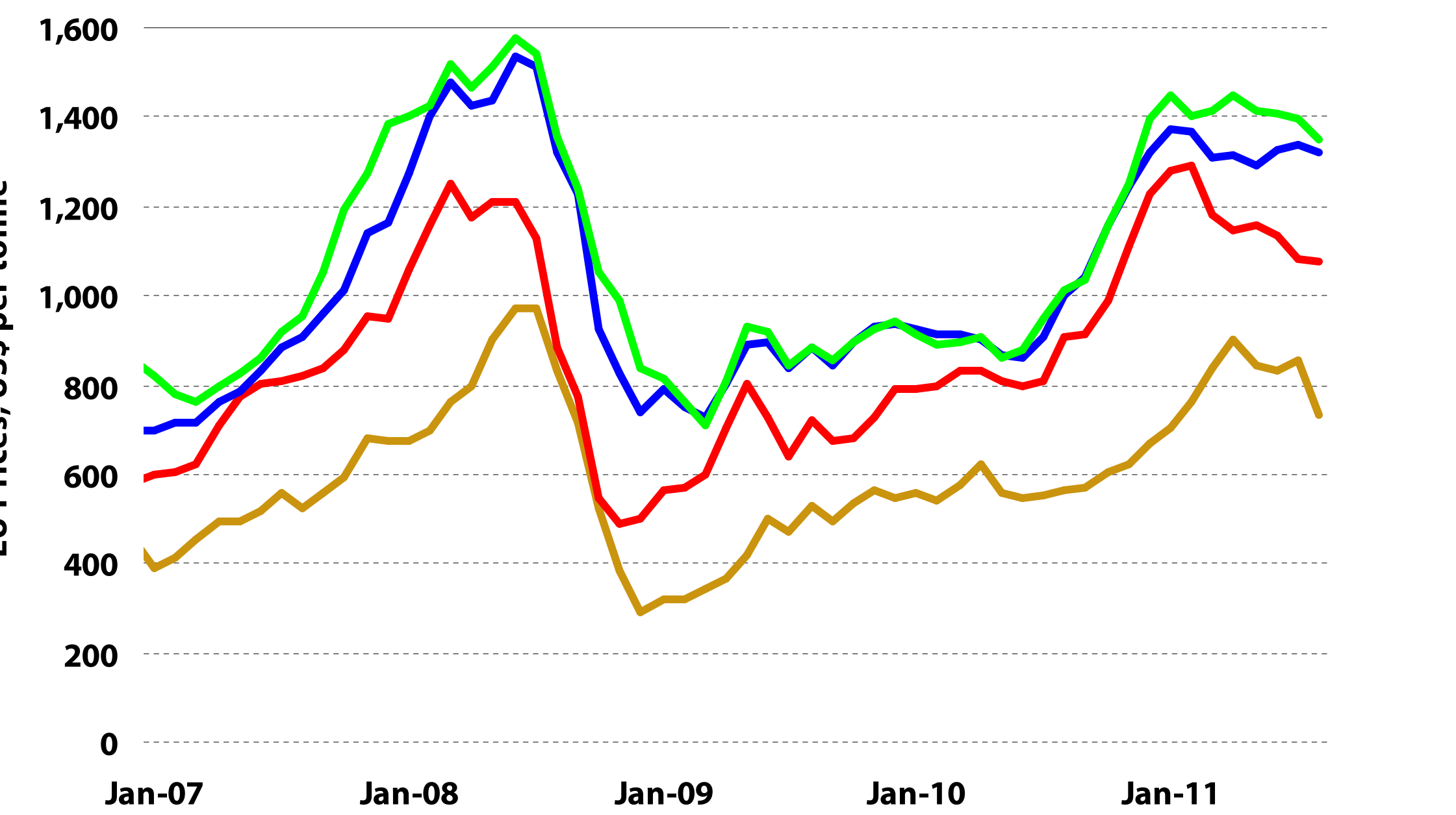
Palm oil stocks are still the main driver of price differentials within the oils complex, and so I will

# The revolution in vegetable oil price behaviour

...cream and vegetable oil prices in 2003 was  
ten cheaper than crude oil per tonne.



by stable oil prices to crude oil prices, within a price band with vegetable oils at a premium.



We can now see very clearly that there is a price band in place, which became established in 2007.

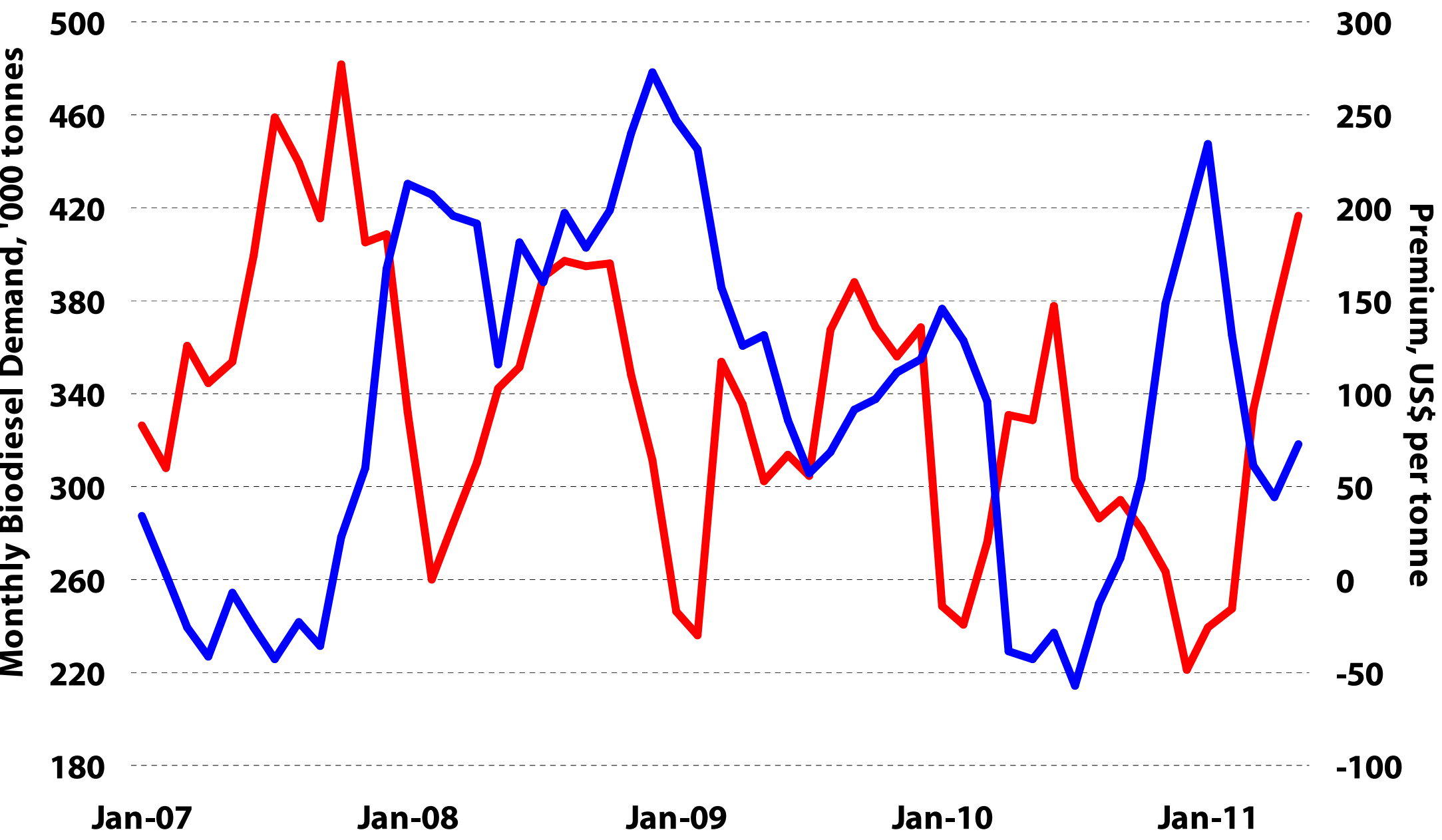
When vegetable oil prices get too far above crude oil, a correction occurs, and typically quite fast. We saw such a correction in 2008 and again this year.

Since the floor of the band is set by crude oil prices, it seems likely that biofuels are the key to the link.

However, I suppose the link could be caused by basic commodity speculation, and so I now turn to examine whether there is a good reason for the band to exist

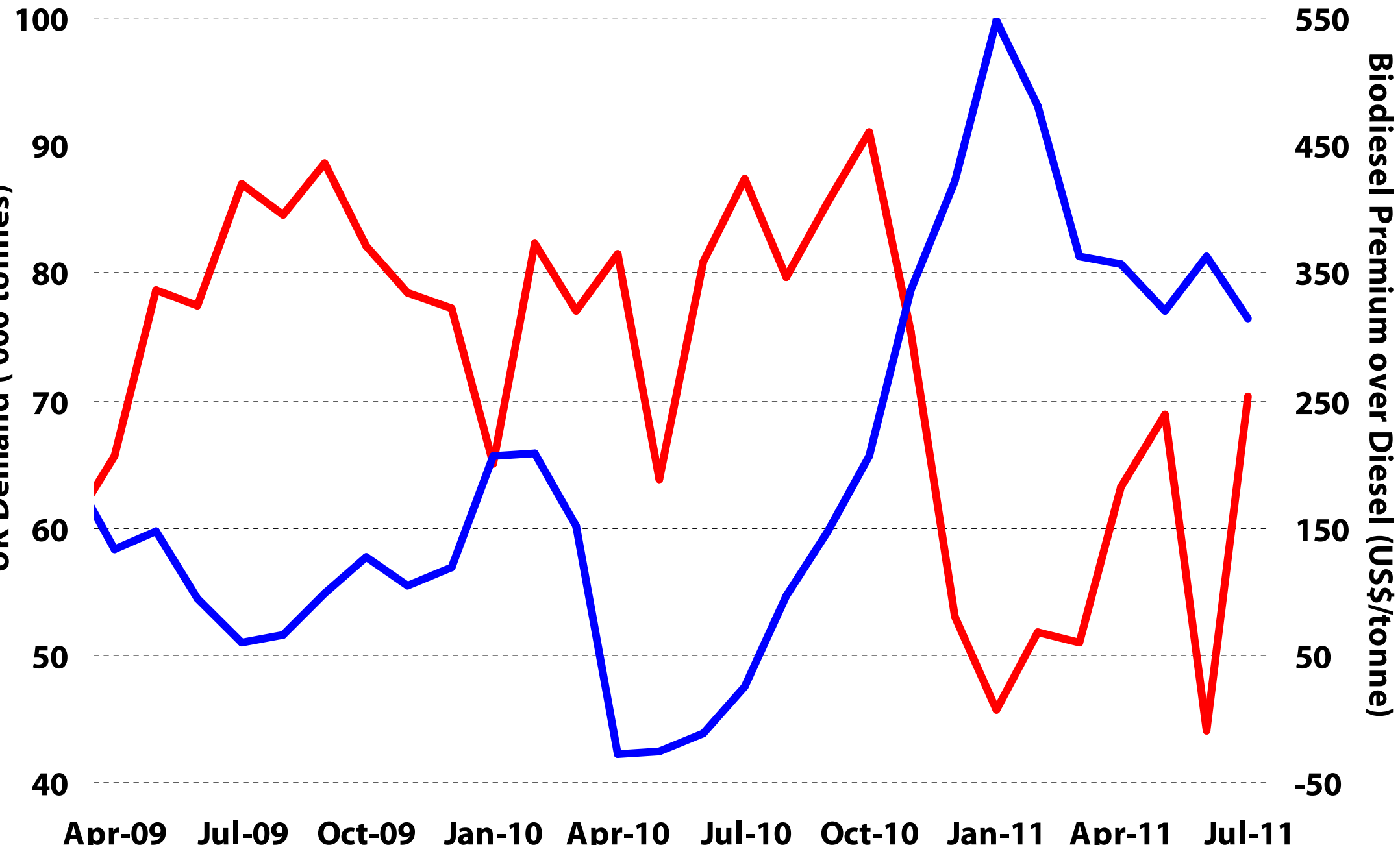
Biodiesel demand is very sensitive to  
the biodiesel premium over diesel

quickly to swings in the biodiesel premium over diesel. This links biodiesel to diesel prices.





money not to use biofuels if they get too costly.



Around the world, biodiesel users cut back demand when biodiesel became very expensive vs. diesel.

Some of the cutbacks were temporary, as blenders waited until biodiesel became cheaper. Some were caused by users “buying out” their mandates.

In a few cases, governments responded to high food prices by reducing their legal mandate targets.

The effect of all these changes was to pull biodiesel prices closer to the price of diesel.

This in turn narrowed the spread between vegetable oil and diesel prices, keeping the price within the

# Understanding vegetable oil prices

I hope that I have persuaded you that you have to take account of biofuels today. We talk about a “tail wagging the dog”. In oils today, the “tail” of biofuels, with only one eighth of world oil demand’ is wagging the “dog” of the global vegetable oil market (with the other seven eighths of demand).

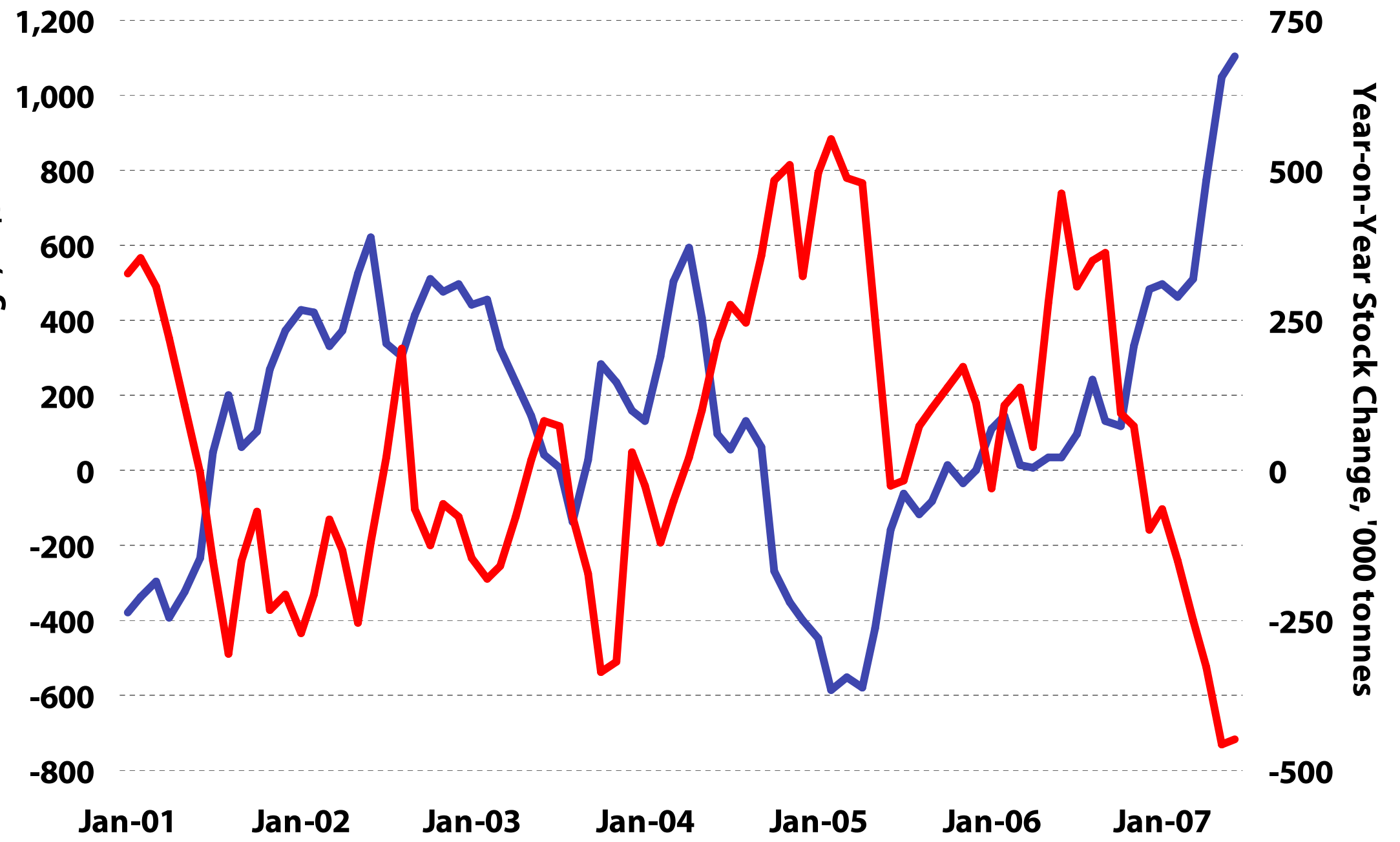
Because of the price band, petroleum prices are undoubtedly a major factor behind oils pricing today.

Stocks also influence prices, as I will now discuss.

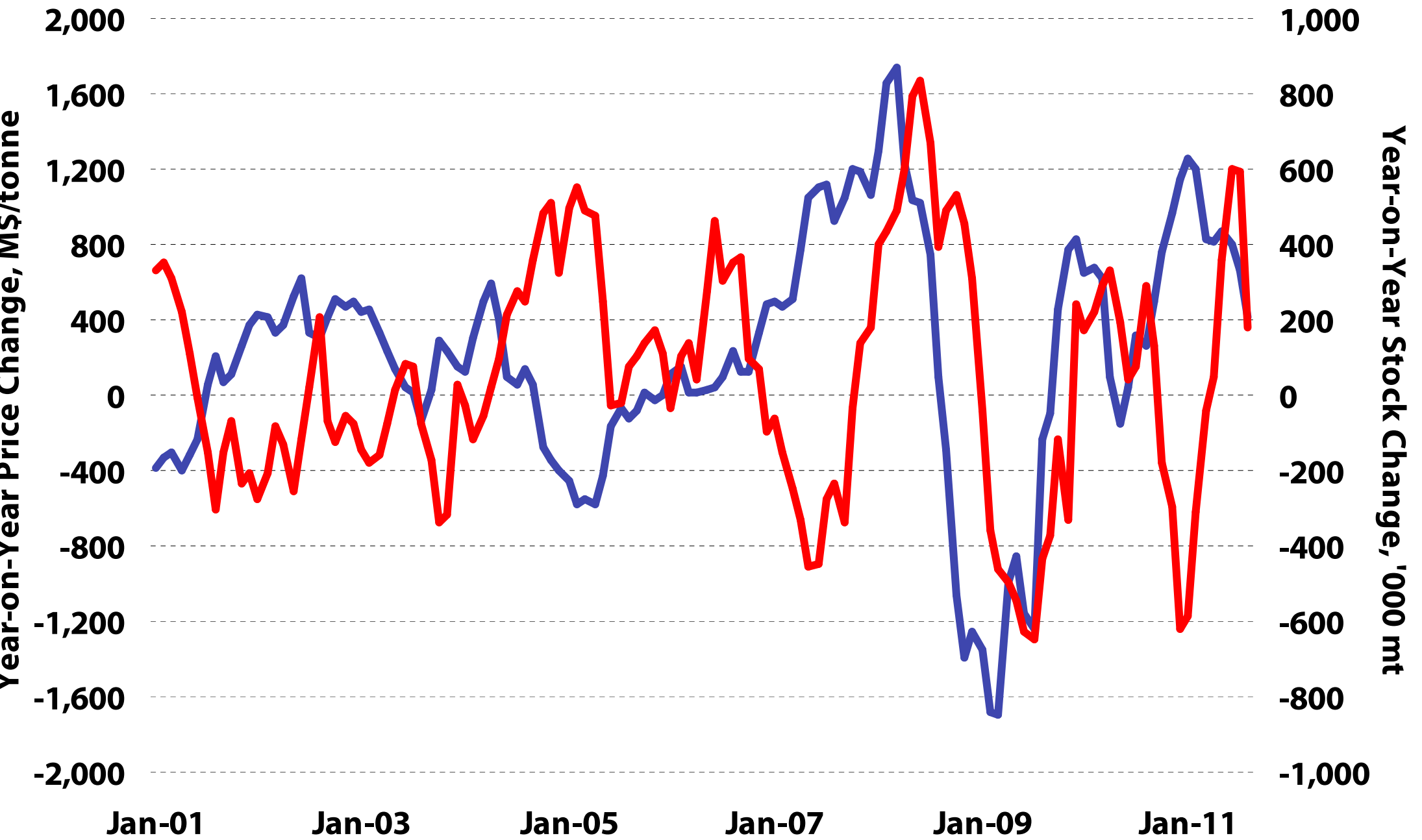
Finally, the recent period of low palm oil production has passed, and so I examine how the palm oil

# What is the role of palm oil stocks?

...ces used to be fairly easily explained in terms of  
changes in Malaysian stock levels.



move together. Prices are still growing year-on-year despite the increases in Malaysian stocks.



# We must look instead inside the price band



It is clear that palm oil stocks (we use Malaysian stocks as the reference) no longer drive CPO prices. Instead, our theories must adjust to reflect the band.

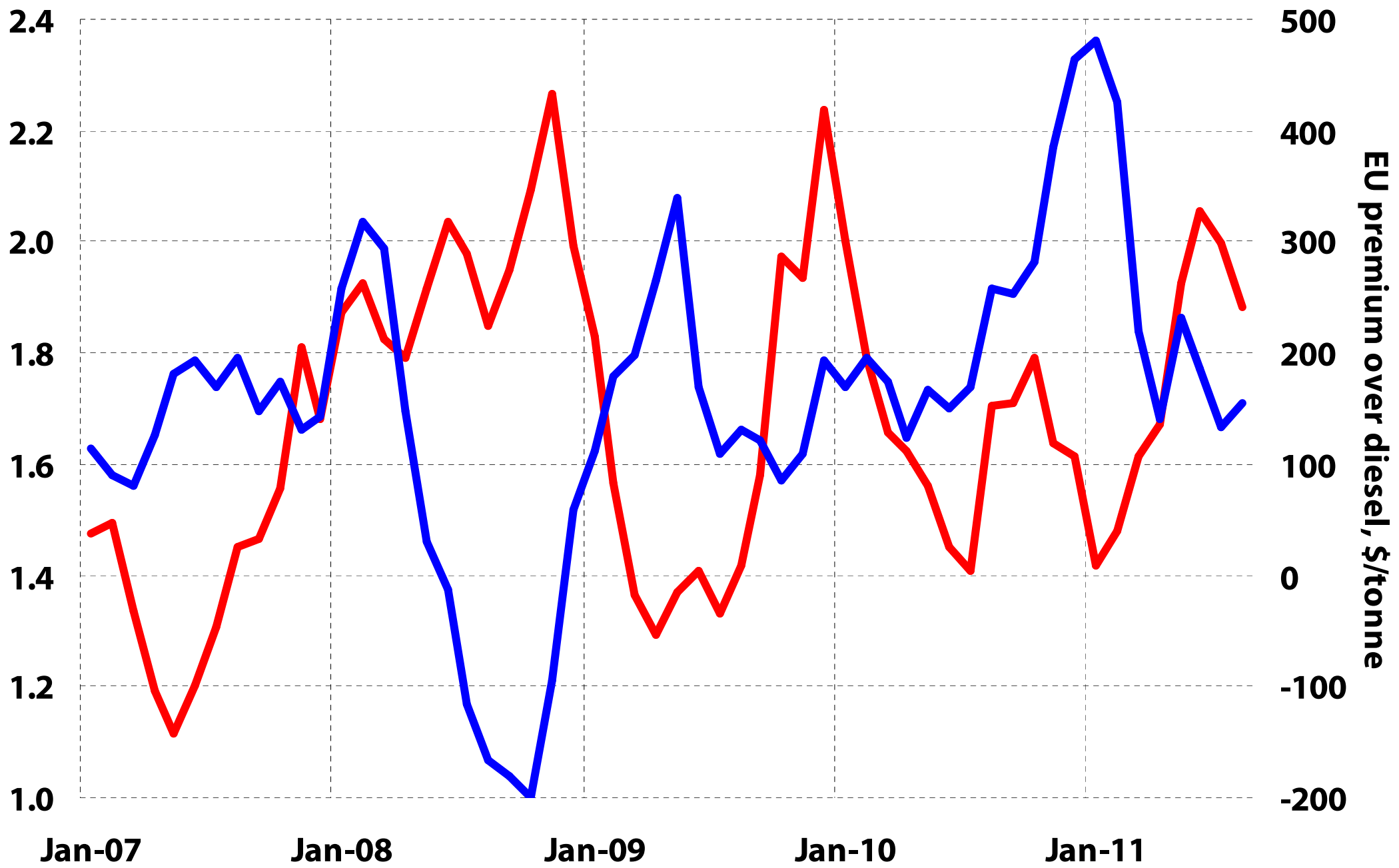
Logic suggests that, with a price band, a floor exists to CPO prices when high stocks have driven prices down so far that it becomes profitable to make and use biodiesel without any government subsidy.

However, when stocks are low, food demand for oils should pull CPO far enough above the price floor for food use to compete oil away from biodiesel output.

So, we expect the CPO premium over diesel to be inversely related to the stock level, i.e., the premium



er diesel. Early in 2011, the premium was too high, but it is now back down near its average.



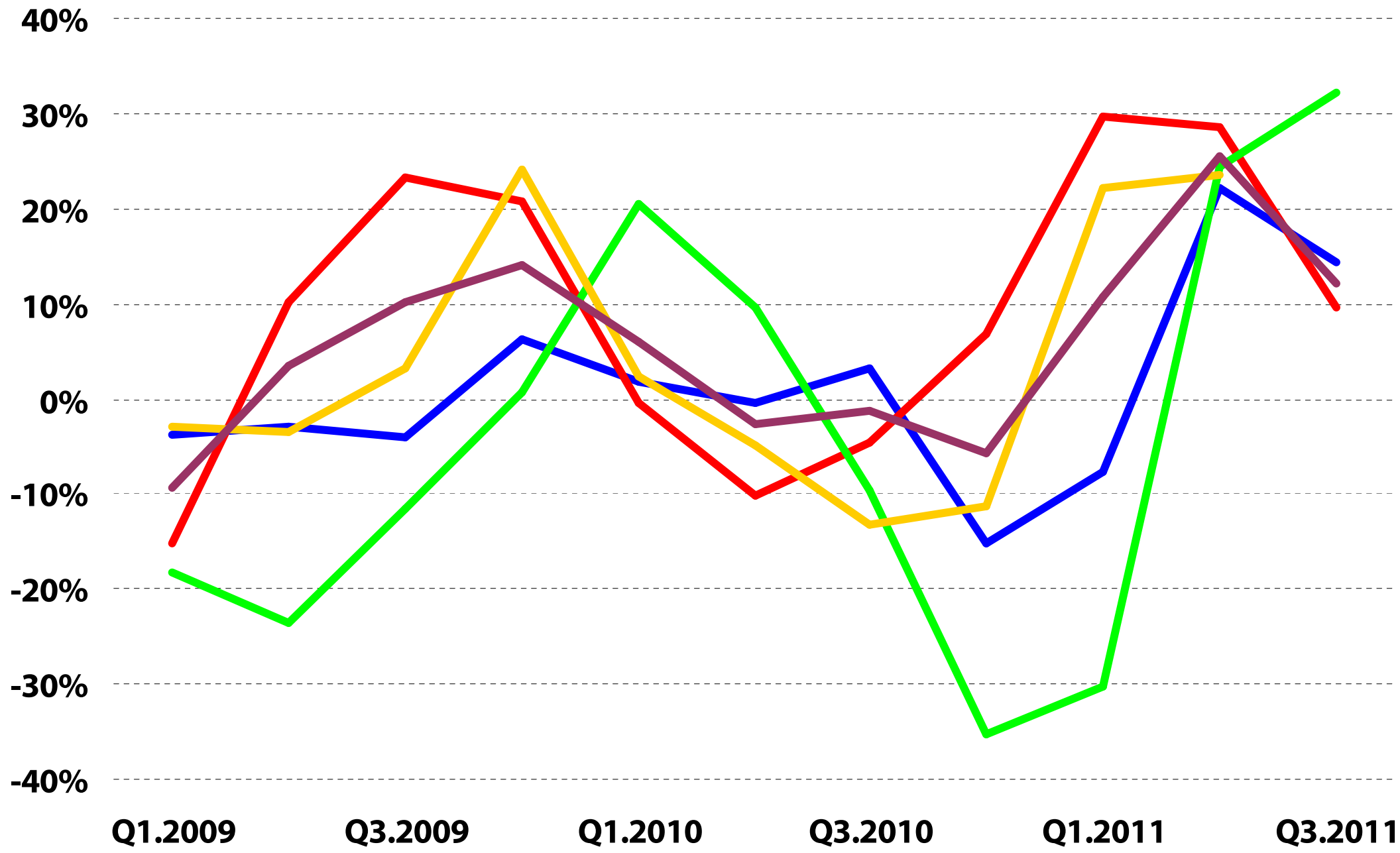


# What is happening to oil palm output?

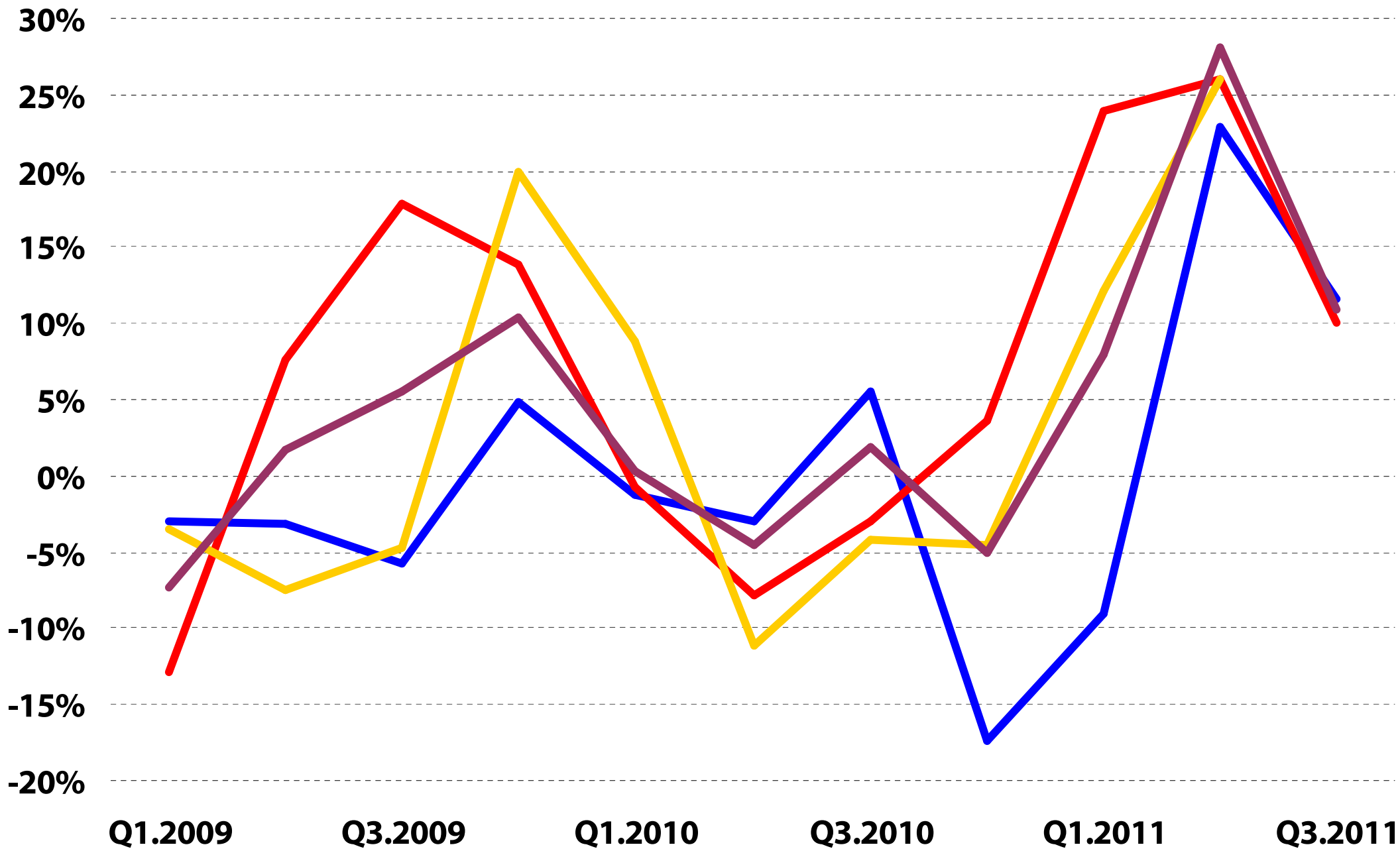
Analysis of Q3 output growth in 2010 was a temporary aberration and that growth is back.



... has been spread throughout the world of palm all the way from SE Asia to S America.



... output in 2010 and early 2011, which explains the recent wild swings in PKO prices.



# oil and palm kernel growth cycles.

2010 was undoubtedly an unusual year, in that the year-on-year increases in both CPO and PK output were very modest by historical standards (which may have been a result of low fertiliser use in 2008-09 in reaction to high costs), and it ended with sharp year-on-year declines in Q4 production of CPO and PK.

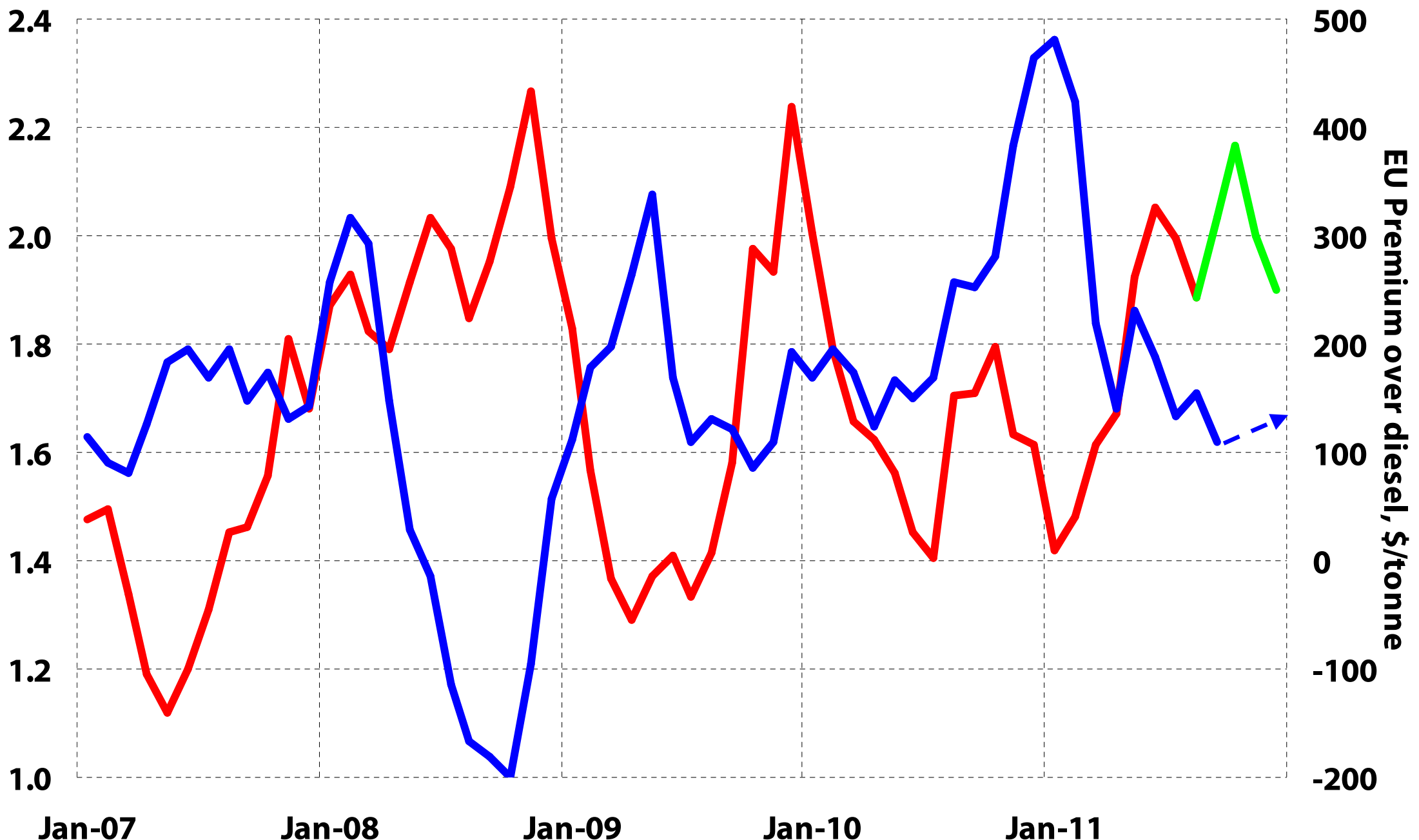
PK output was hit harder than CPO in the downturn (causing PKO prices to soar), but displayed very strong growth again by the second quarter of 2011.

Looking at the growth patterns, we must be close to the peaks. Malaysia's and Indonesia's year-on-year growth rates peaked in May-June, while the Thai rate



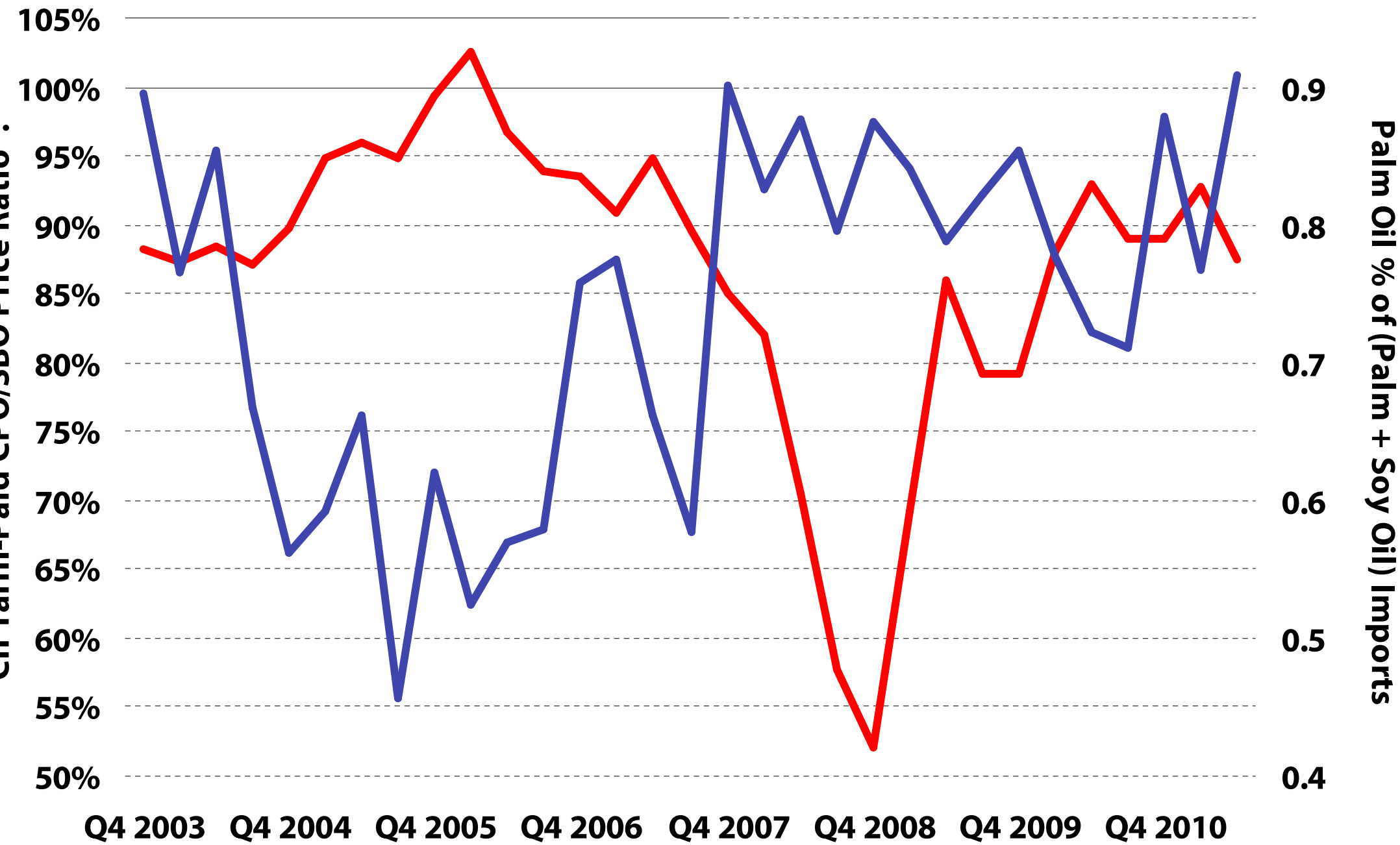
# ne outlook for stocks and differential

premium over diesel rose a little, but not back to the peaks of early this year.

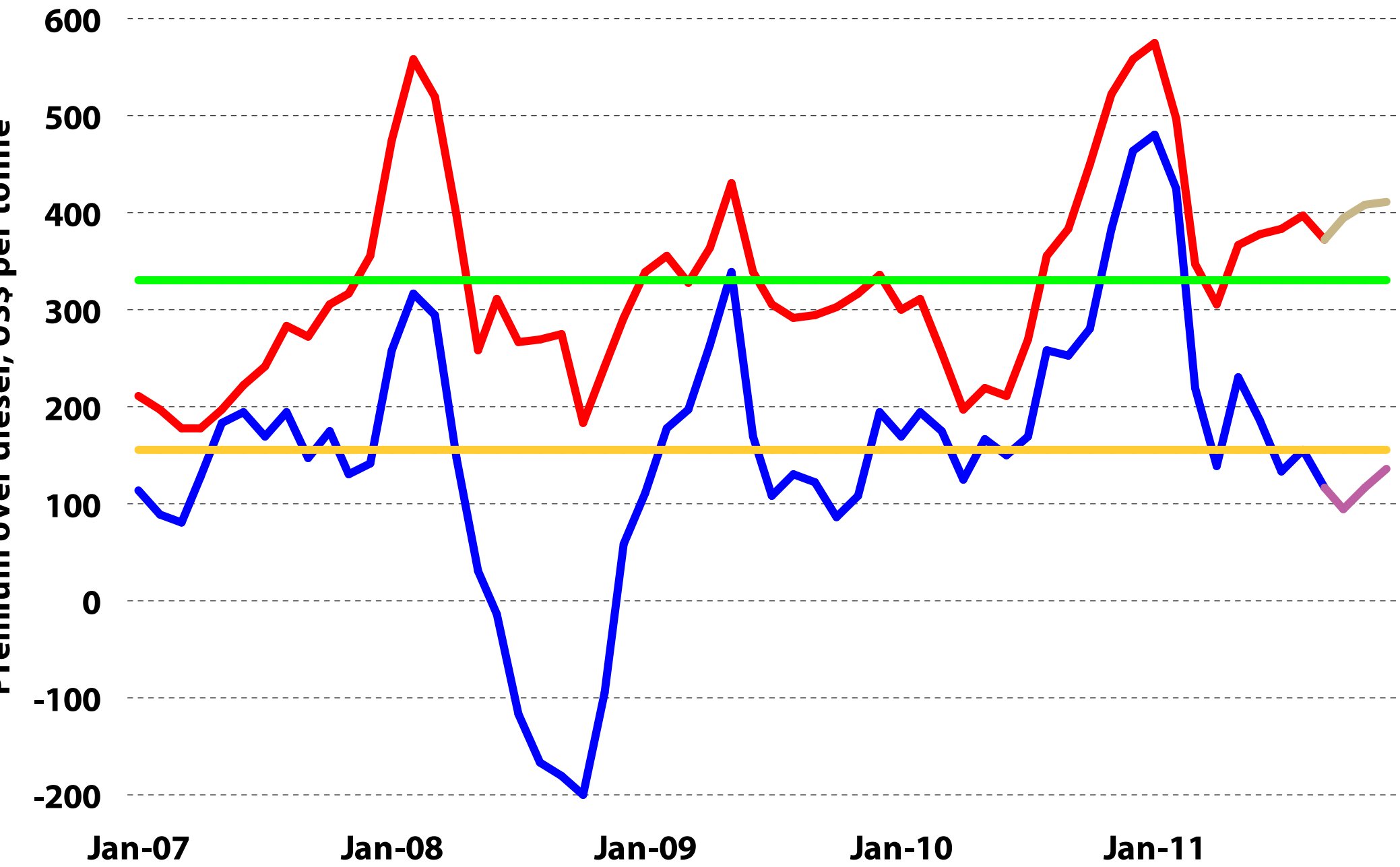




and soy oil in vital markets such as India keeps  
oil prices from moving too far above CPO.



Normal, the soy oil premium, already above normal, is not expected to rise much further.



We must analyse the petroleum market as well as supply-demand in vegetable oils.

The picture I have described is quite different from the one that you may have expected.

We are now in a “new world” in which vegetable oils trade in a price band, created by biofuels, which links vegetable oils inextricably to the petroleum price.

The old fashioned drivers of oils prices, i.e., supply-demand and stocks, are still a factor in setting prices but the supply-demand balance only influences prices within limits that are set by petroleum.

Thus, as if you don't already have enough to do, you

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