

Key factors driving vegetable oil prices round the world today

Presentation by Dr James Fry,
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Outline of my presentation

I will explain how the determinants of the prices of vegetable oils, and of palm oil in particular, have changed since 2007.

I demonstrate how the influence of stocks on the price level has been transformed in the same period.

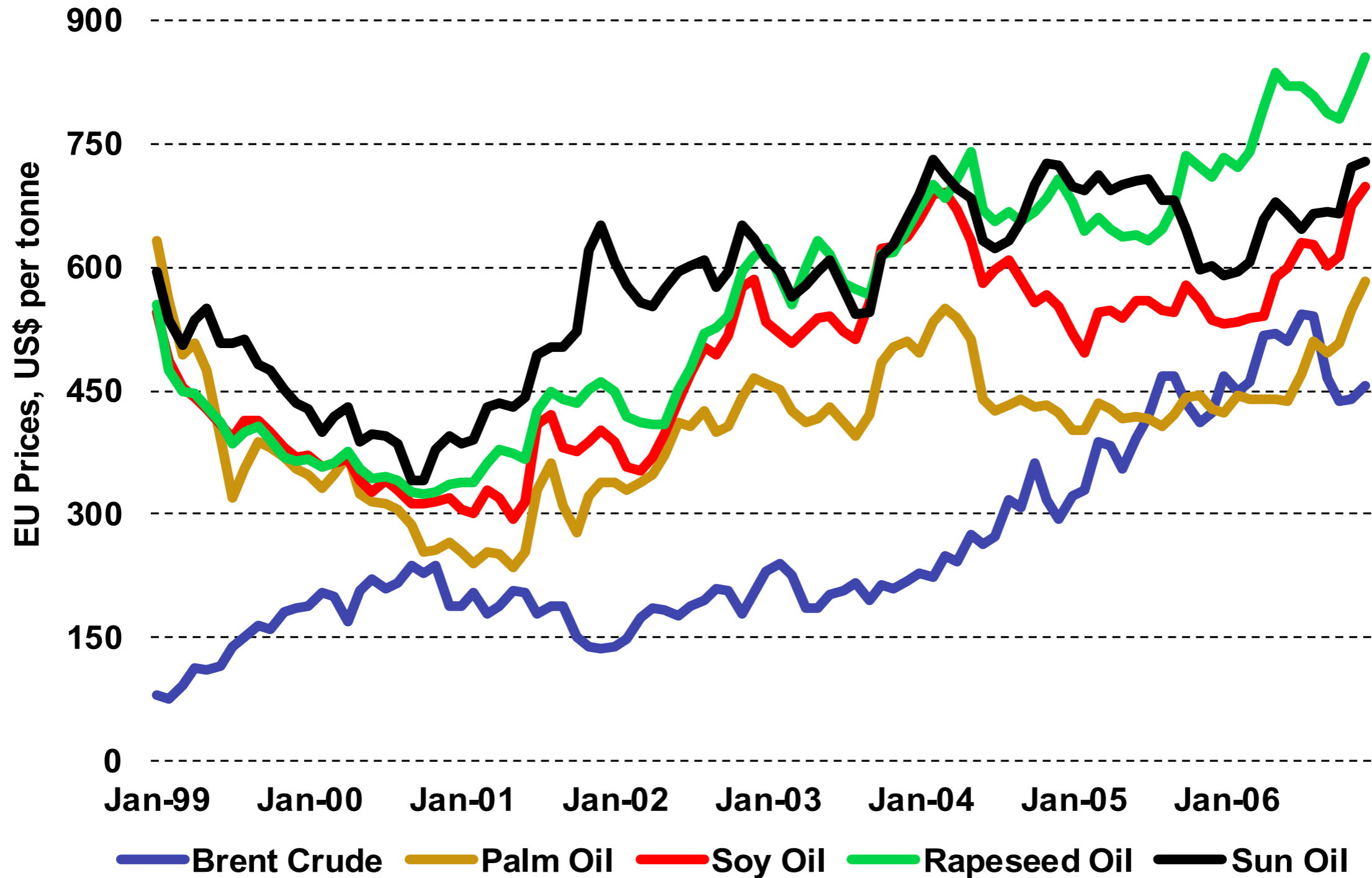
I describe the influence of the global fuel and biofuel markets on the prices of vegetable oils.

In particular, I will show you how and why petroleum prices now underpin the prices of oils.

I will examine the way in which the prices of all major oils are being pulled closer together, and highlight the factors to look out for in the next few months.

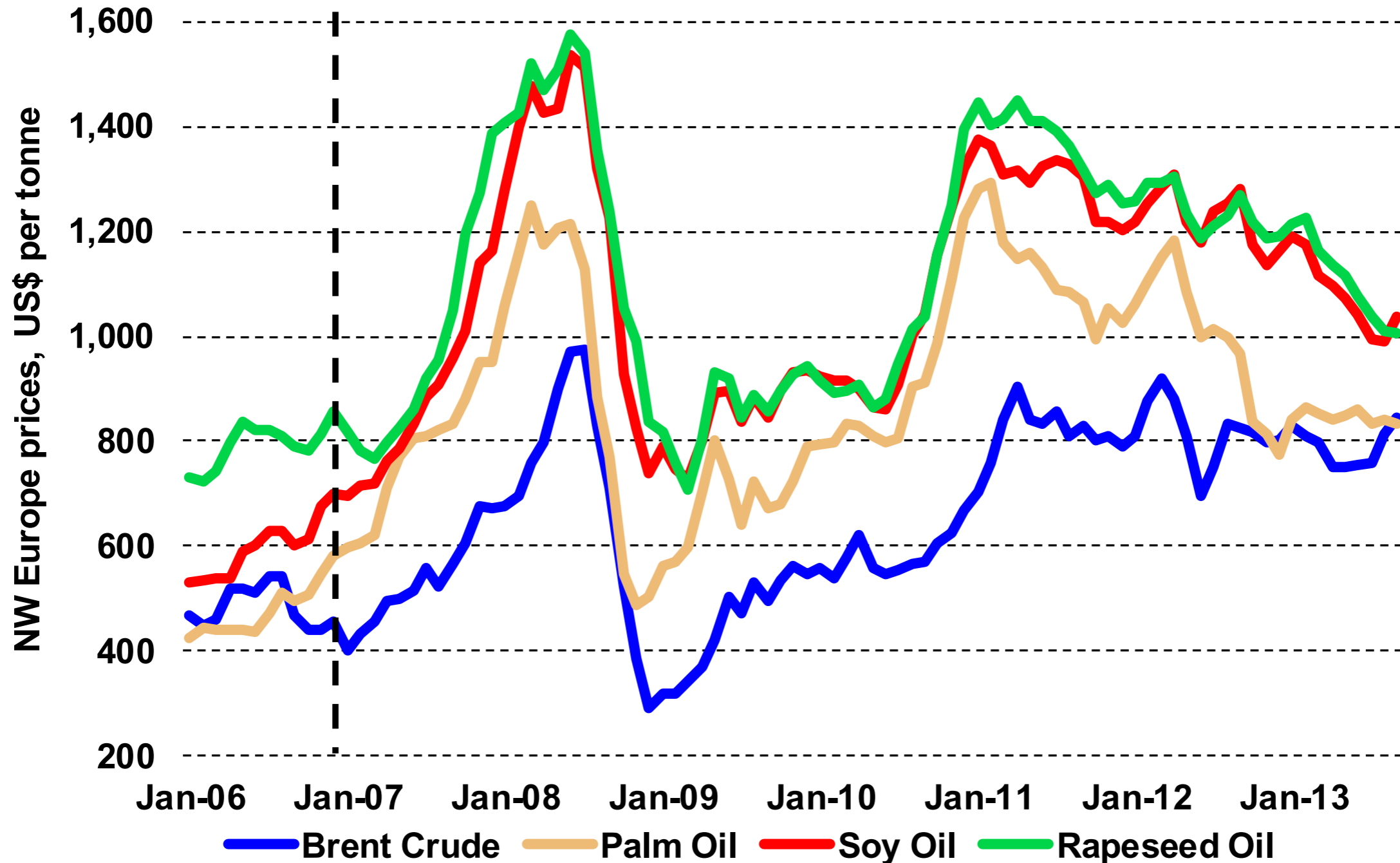
What used to determine prices of oils?

Before 2007, EU petroleum and vegetable oil prices moved in different directions. CPO, as the cheapest vegetable oil, captured new markets.

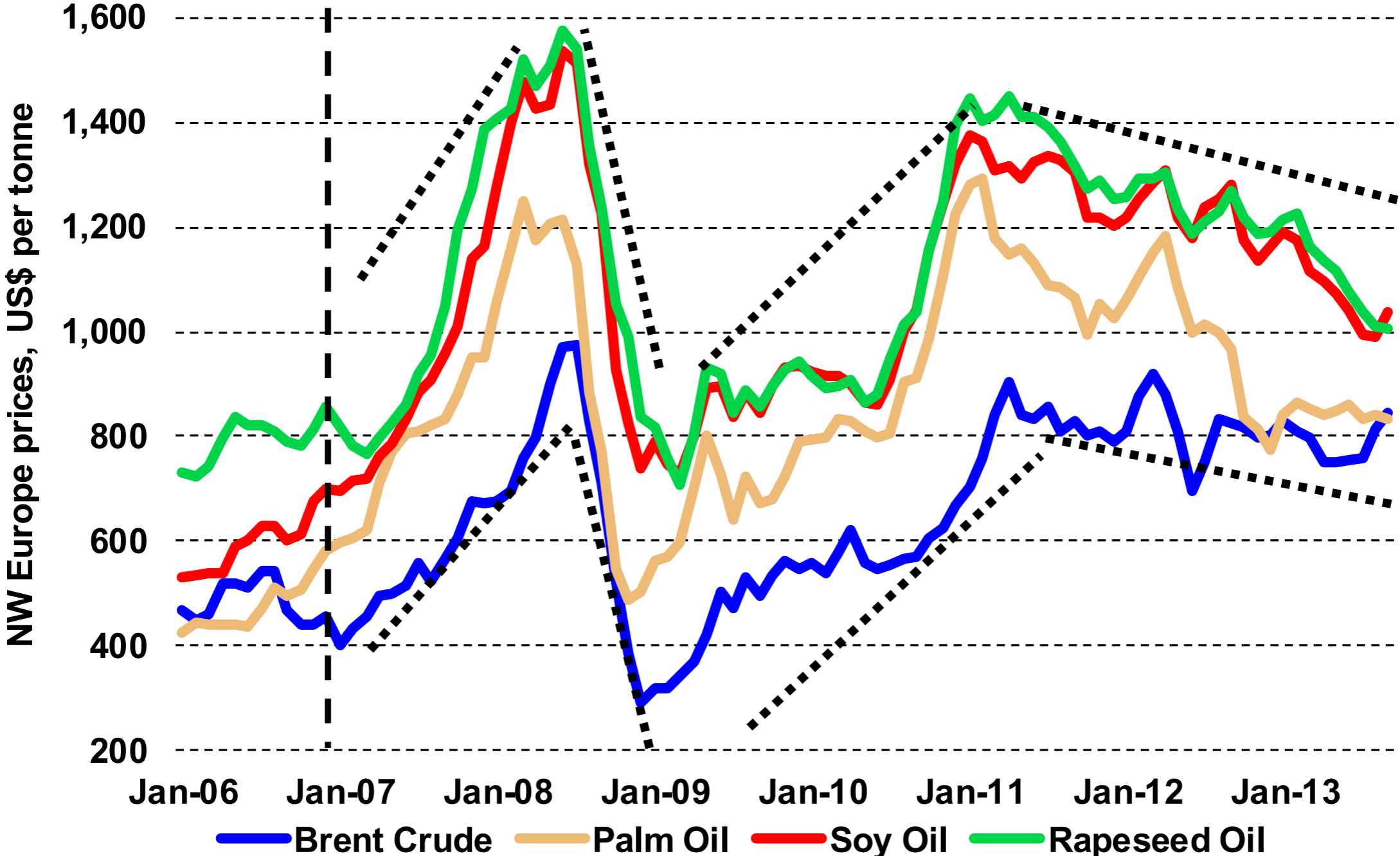


The “new world” since 2007

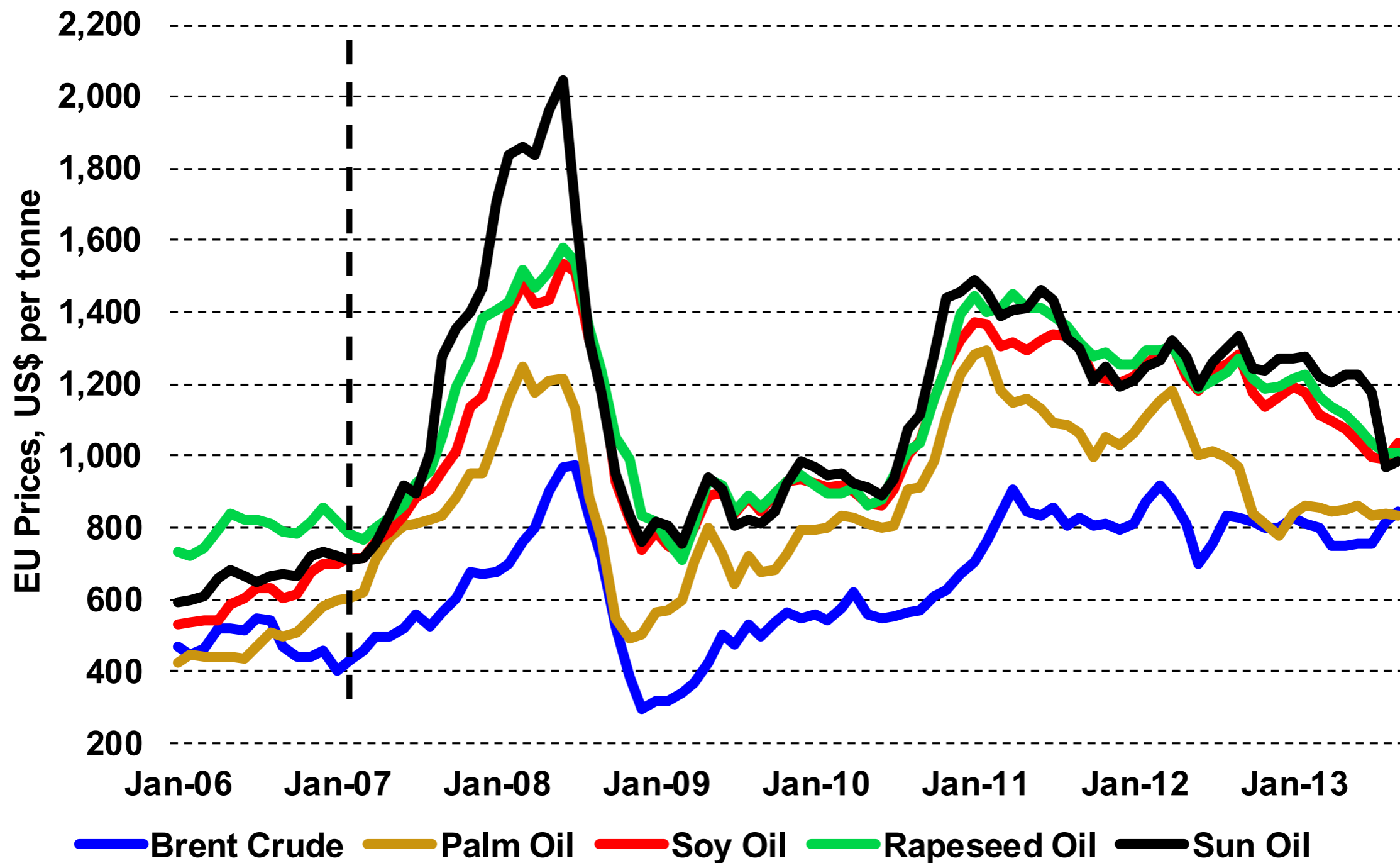
Since 2007, the behaviour of vegetable oil prices has been transformed. They are now linked to petroleum prices within a very clear price band.



Here I have drawn a simple price band around the prices of the three major vegetable oils and Brent North Sea crude petroleum.



Sunflower oil moved briefly out of line in 2007/08 after a poor sunflower crop in Russia & Ukraine, but it has since moved back into the price band.



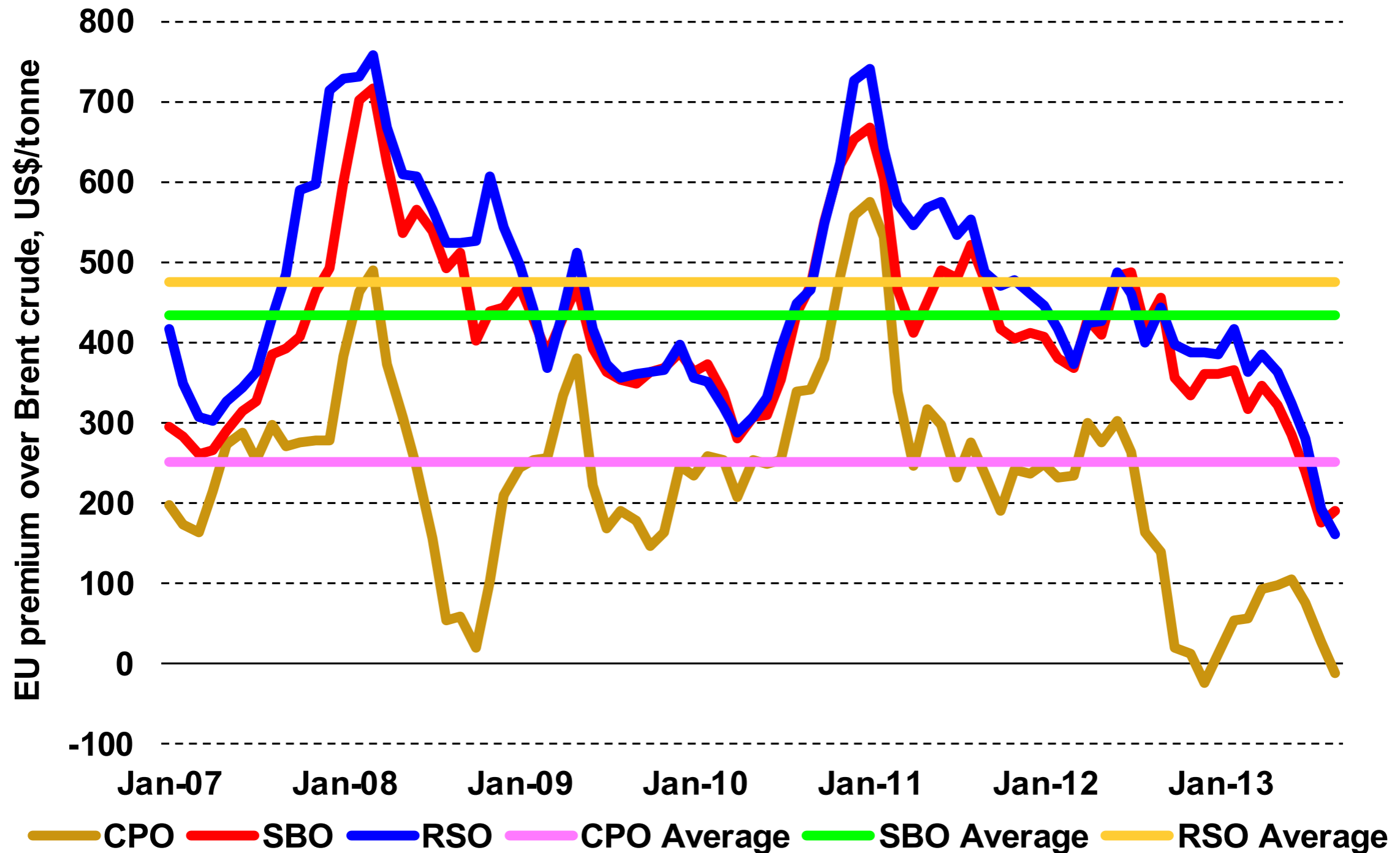
The forces that drive vegetable oil prices have changed. Vegetable oil prices now behave as if they are part of the petroleum complex.

We can see that prices of the main vegetable oils are more or less trapped in a cage that links them to petroleum prices. (The petroleum price that we use is the Brent North Sea crude price, which is the price reference for most world trade.)

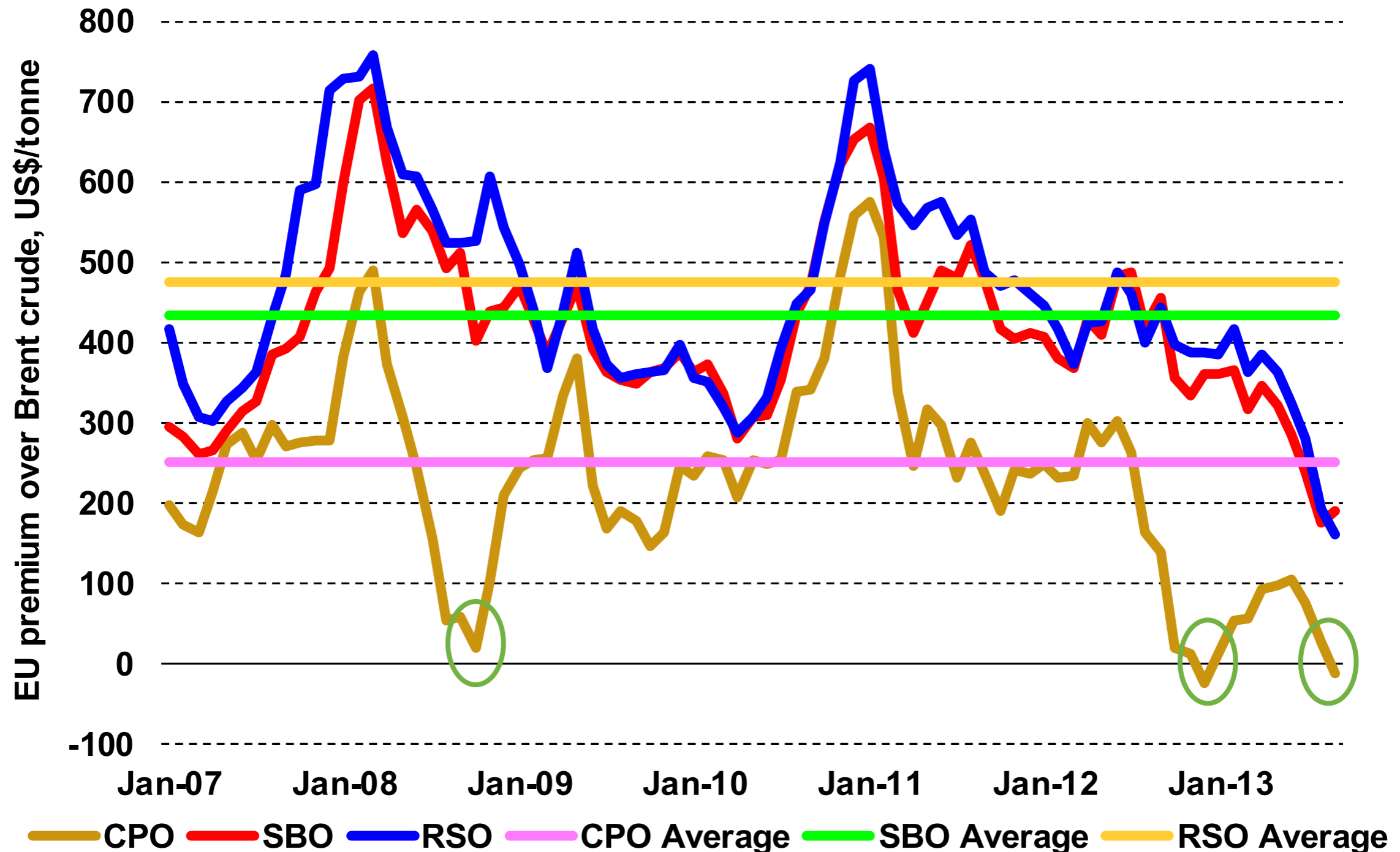
Brent crude sets the floor to the price band, while palm is the vegetable oil whose price is closest to this floor.

The prices of the other main vegetable oils, soybean, rapeseed and sunflower oils, have traded very close to one another since 2008 and their prices have been more stable than that of palm oil within the price band.

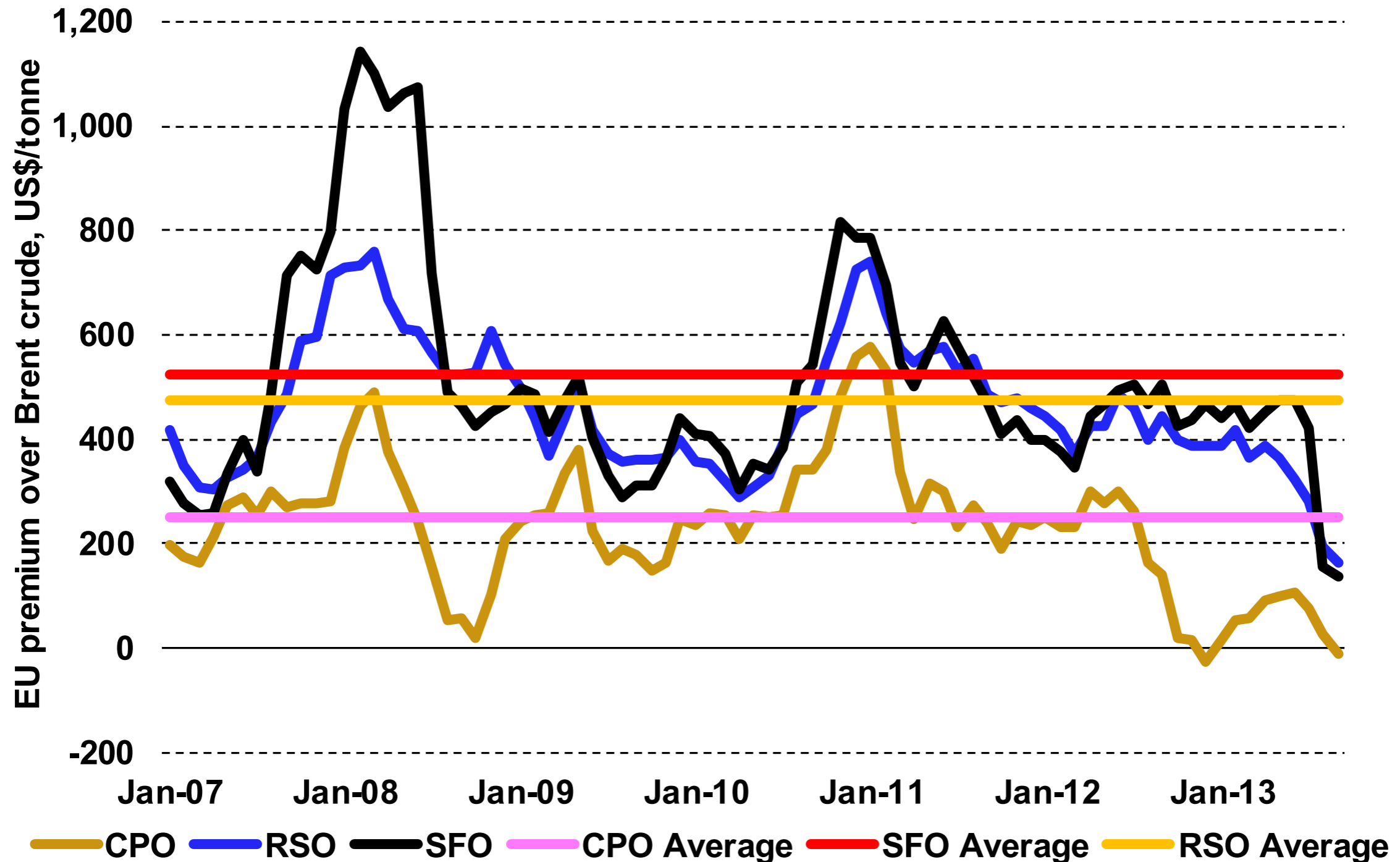
Because of the price band, attention should now focus on differentials inside the band. Here I plot the premia of the three main oils vs. Brent crude.



Note the three times (today is the third) when the EU CPO premium stands at zero, i.e., the CPO price equals the Brent North Sea crude oil price.

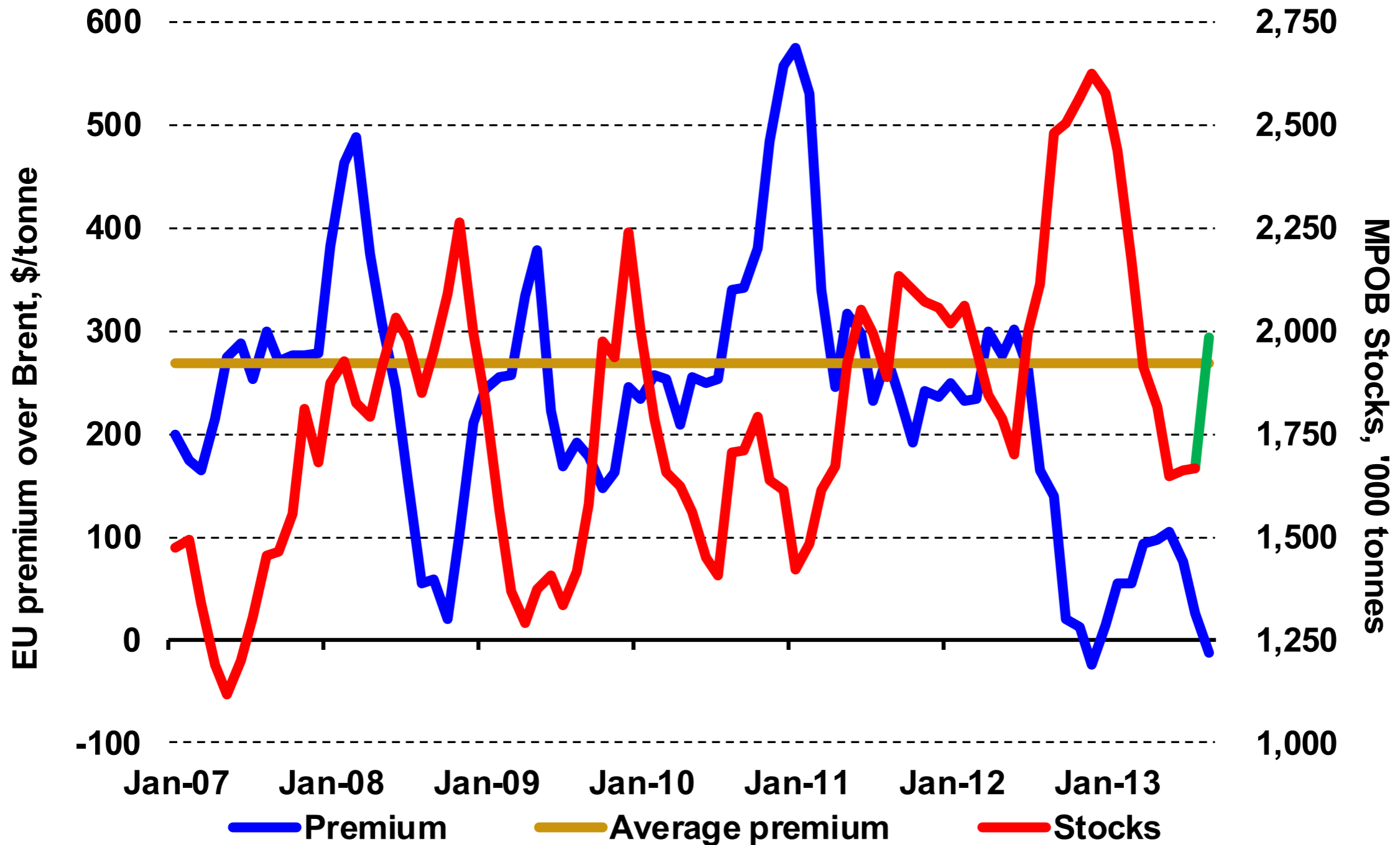


In 2007/08, the poor sunflower crop took the sun oil premium far above that for other oils, but it has now moved into line with other seed oils.



What determines the premium for vegetable oils over Brent crude?

The answer is palm oil stocks. They determine the EU CPO premium over Brent. We see here how the premium varies with Malaysian stocks.



Since 2007, Brent crude oil has set the floor to EU CPO prices. Malaysian palm oil stocks set the direction of the CPO premium over Brent.

Brent crude prices lie at the bottom of the price band.

Malaysian palm oil stocks (the only reliable stock data that we have) are crucial in determining the level of the EU premium for CPO over Brent prices.

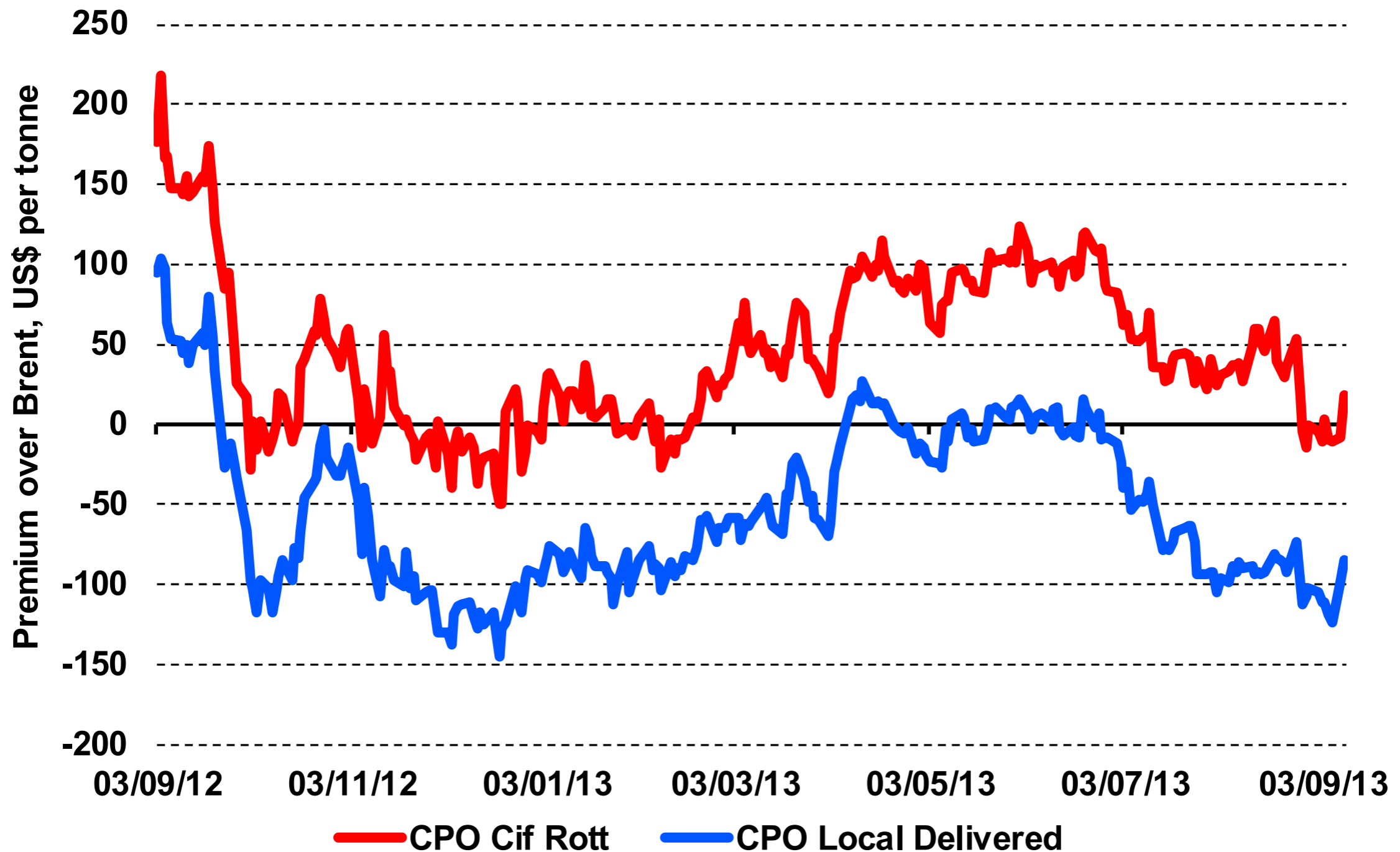
In the past two years, the premium has fluctuated between a peak of \$300 a tonne 15 and 30 months ago, when stocks were low, and a floor of zero nine months ago, when stocks were at an all-time high.

High stocks => a low premium; low stocks => a high one.

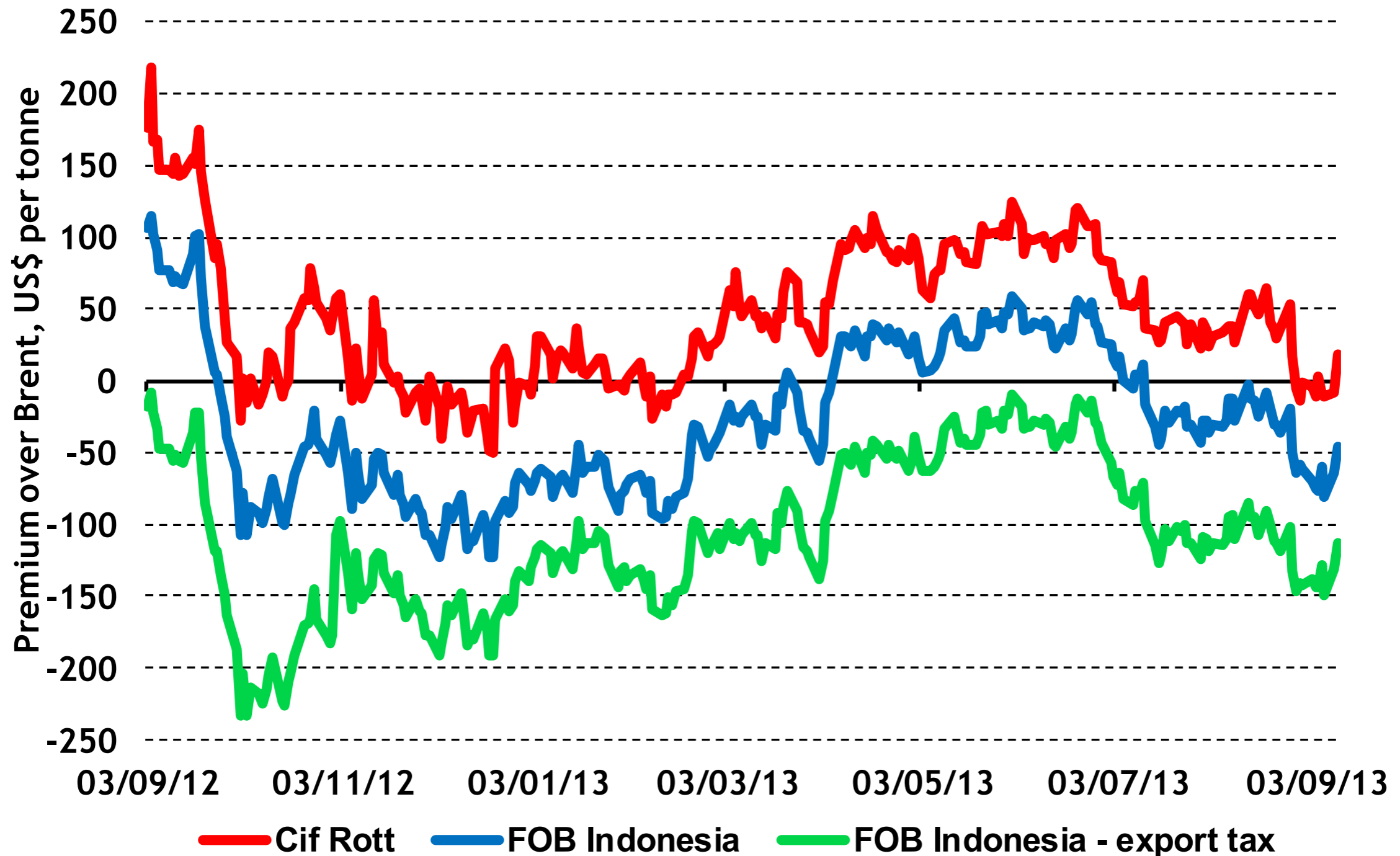
In the past 3 months, the market has accepted these realities and started to look ahead. Today's premium is again at zero, even before the seasonal jump in stocks.

How did the price floor hold firm in the face of the highest ever stock levels?

The answer: CPO was cheaper than crude oil in S. E. Asia. EU (red) and Malaysian (blue) premia over Brent differ by sea freight costs to the EU.



Indonesian export taxes pull its local CPO prices (green) down to a much bigger discount to Brent than those at a FOB level for exports (in blue).



Freight costs to the EU and export taxes have reinforced the floor to the price band



There is no doubt that fuel uses of palm oil (without any official subsidies) are now profitable in S.E. Asia.

This was because freight costs translate the floor to the EU price band (which is where CPO prices equal those of Brent crude) into an FOB CPO discount in S.E. Asia.

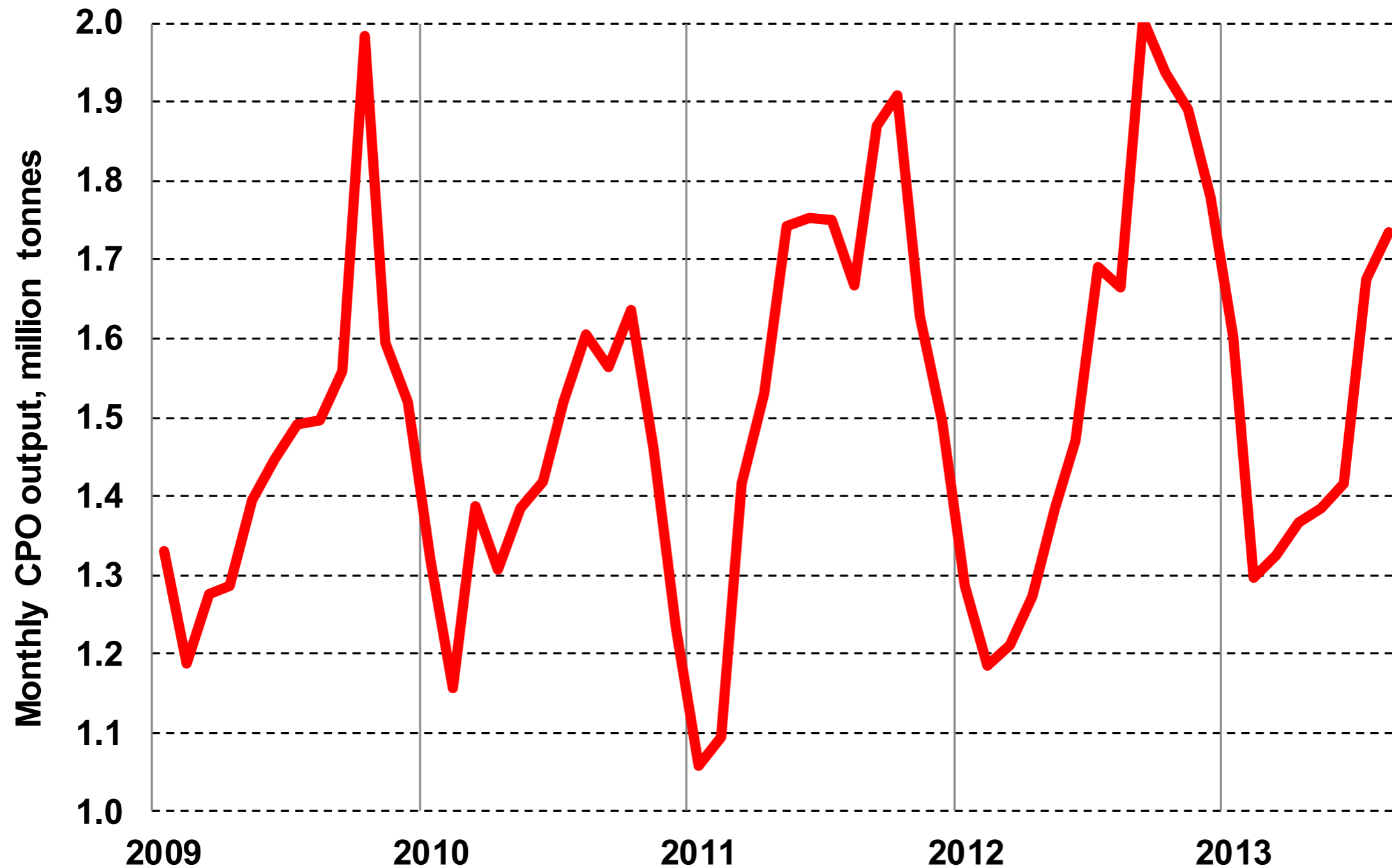
Export taxes reinforce the appeal of turning CPO into biofuel in Indonesia and (to a lesser extent) Malaysia.

This is because a local CPO seller cannot avoid the impact of the export tax. Competition between traders selling for export and to the local market ensures that local prices = the FOB export price *minus* the export tax.

Today, Indonesian CPO is \$110 cheaper than crude oil. In Malaysia, local CPO is \$85 cheaper than crude oil.

Where do we stand in the palm oil seasonal production cycle today?

There is always a seasonality to palm oil output. Here you see how monthly production fluctuates in Malaysia, peaking just before the year-end.



The recent weakness of the CPO premium is curious in that CPO stocks are not yet high.

We are back where we were 9 months ago, with the costs of making biodiesel inside Malaysia or Indonesia significantly below local free market diesel prices.

Export sales of palm biodiesel to the US and EU markets are again profitable without export subsidies.

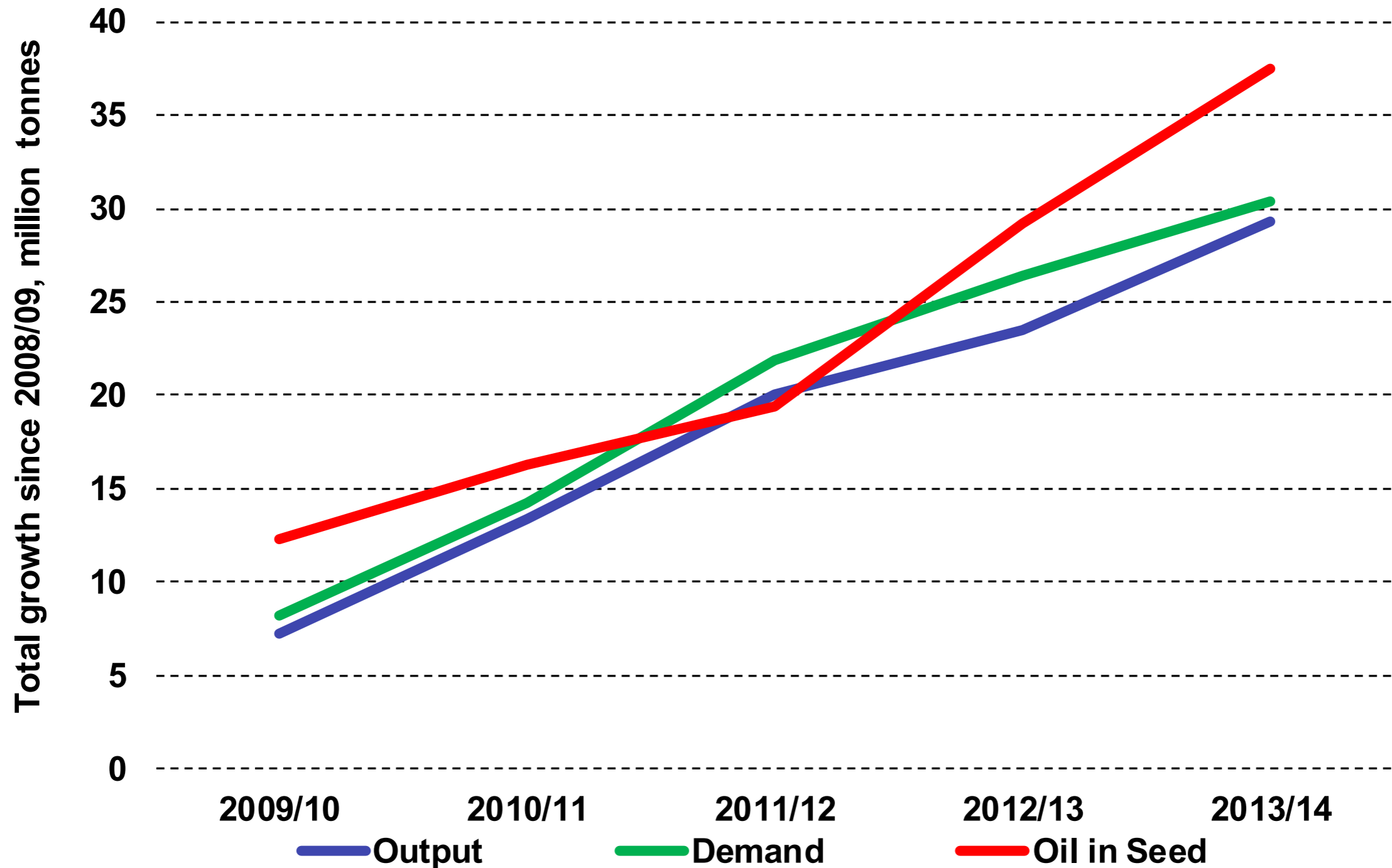
Malaysian palm oil stocks are 450,000 tonnes (21%) below where they were 12 months ago, which is partly caused by the weakness of year-on-year output growth.

CPO output will peak in October-November as always, but stocks will not get as high as last year. One reason is that S.E. Asian local biodiesel demand is growing.

To explain weak CPO prices we must look elsewhere.

Are developments in other oilseed markets behind the recent price falls?

World supply and demand for the main oils move in step (see the total growth since 2008/09). The oil left uncrushed in seeds balances the market.



It is normal to hold surplus oilseeds as seeds, rather than turn them into surplus vegetable oil

Oil palm is very special. It is not only the world's largest source of vegetable oil, it is also the only major oil crop that cannot be stored as a seed and must be crushed almost immediately to obtain oil. This is why palm oil stocks are so important in leading the prices of all oils.

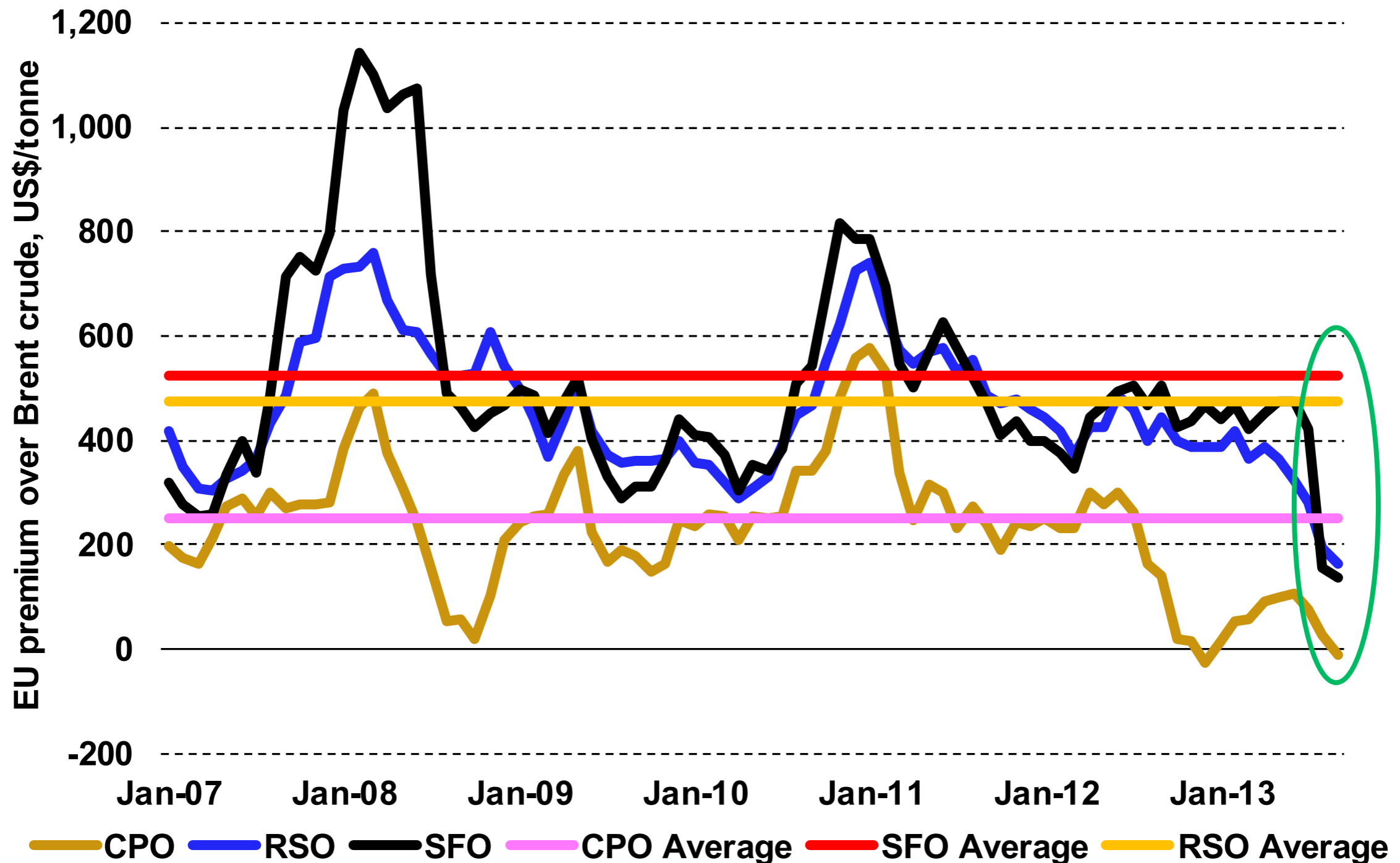
All other oilseeds, sunflower, rapeseed or soybeans, are crushed only when there is a demand for output.

Sunflowerseed and rapeseed are crushed for oil.

Soybeans are crushed to meet the demand for meal.

The net result is that there is only a small imbalance between the growth in total supply and demand for oils.

It is interesting to see today how the different oils prices are moving closer together and, at the same time, the premia over Brent are falling fast.



We have a puzzle. Seeds are not being crushed to be left in tanks creating a large surplus of oils. Palm oil stocks are not high. Yet prices are weak.



In the case of palm oil, we are now back at prices in S. E. Asia that are far enough below crude oil to make biodiesel a competitive source of diesel fuel locally.

Action in Indonesia to boost the mandate for biodiesel in cooperation with local fuel companies will also help. (Malaysia is proving surprisingly slow in its mandate.)

Palm oil is a competitive fuel, but other oils have relied on local biofuel mandates to lift their prices. However, support for biofuels is slipping in both the EU and US.

As a result, we may be witnessing a structural change in seed oils markets. They may have to compete more directly with petroleum to make sales of biodiesel.

Conclusion: If support for biofuels does not revive soon in the EU and US, we may expect seed oil prices to trade closer to CPO in future.

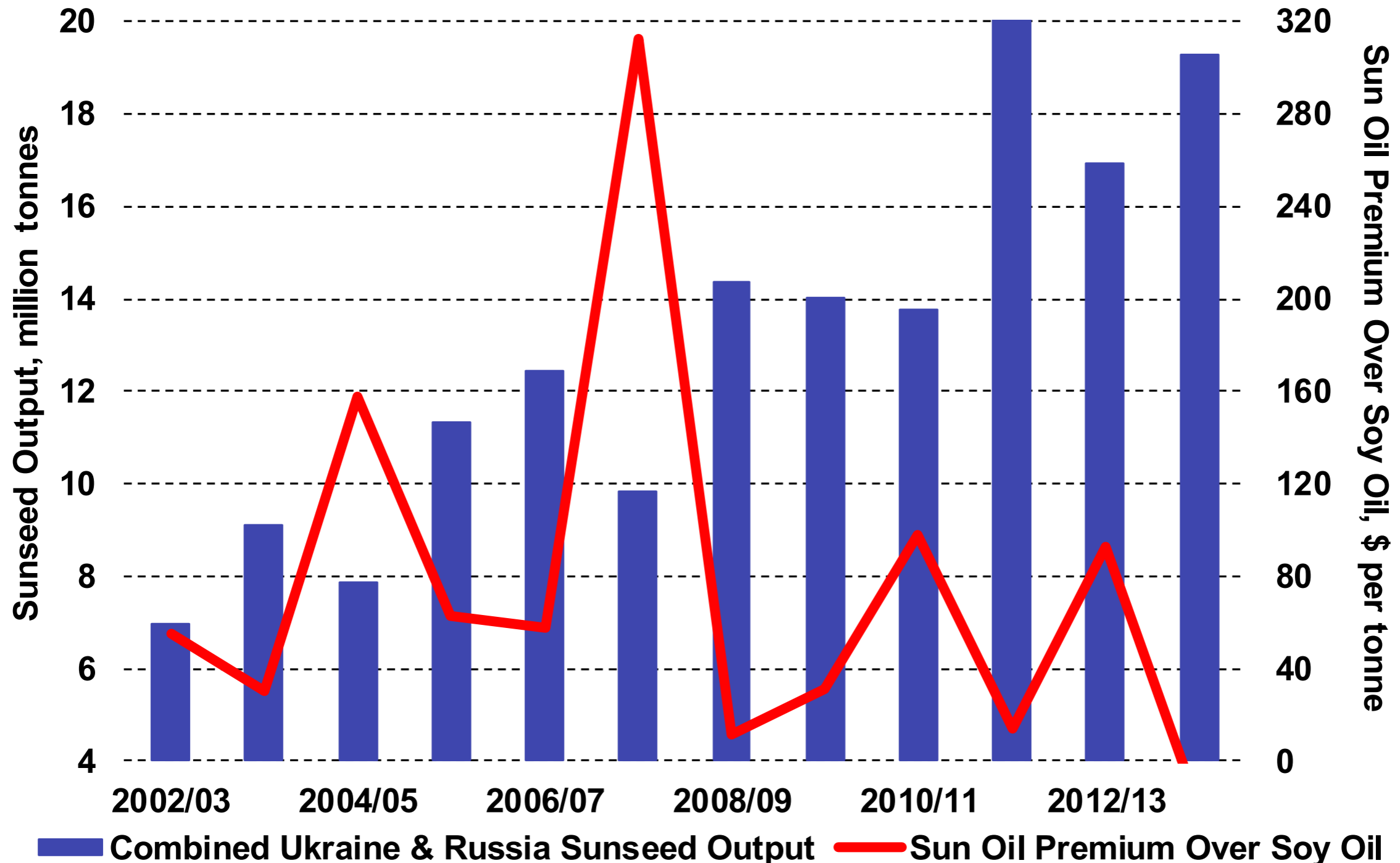
It may sound paradoxical, but the weakening of the support for biofuels may force all vegetable oils to become more than ever part of the petroleum complex.

This is because the supply of oilseeds and oils has increased around the world to meet the new demand that was being created by governments for biodiesel.

If that demand becomes less sure, then these supplies will have to buy their way into more price-sensitive fuel markets, thus follow the path followed by palm oil.

In the sunflower sector, too, you will have to analyse petroleum prices even more closely than you do today.

My last slide reveals how sun oil competes with soy oil on price as sunflower output fluctuates. Such competition will increase in importance.



Thank You



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