

Taxes, tariffs and palm oil prices



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Outline of my presentation today

I will start with a review of the impact of Indonesian export taxes and Indian import tariffs upon downstream margins in the palm oil sector.

Then I will discuss how this has affected the structure of prices in the vegetable oil complex.

I will turn to an update of the prices behind the price band, which links vegetable oil prices to those of petroleum products and to stock levels.

I will demonstrate that the band is alive and well, and that it has been the main driver behind the behaviour of world market prices over the past three very turbulent months.

The influence of Indonesian export taxes

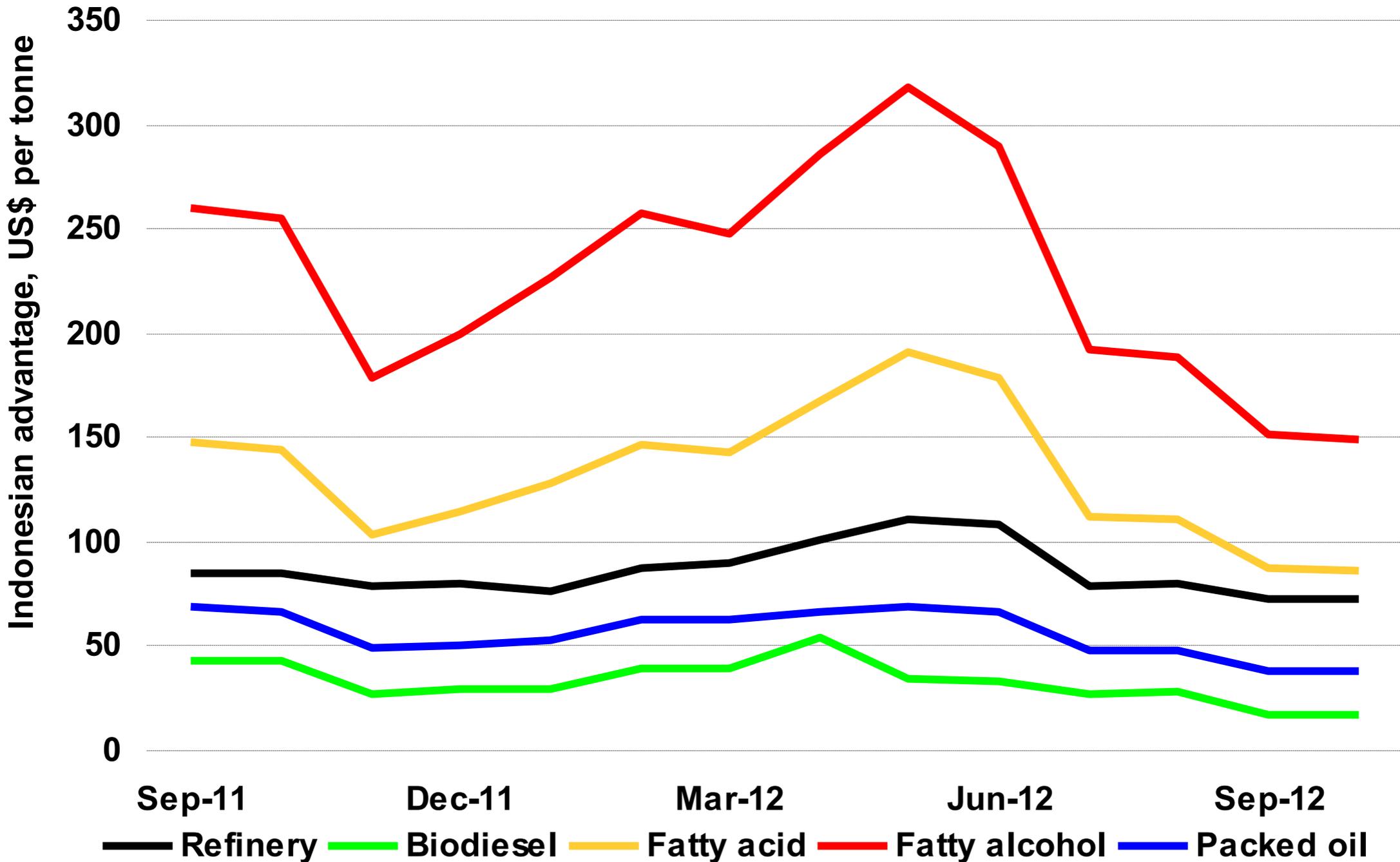
The impact of Indonesian export taxes

In the next diagram, I will show you how the different levels of export taxes in Indonesia would have given Indonesian exporters an advantage over their Malaysian competitors, assuming that all export products had been priced inside Indonesia at the FOB price *minus* the export tax.

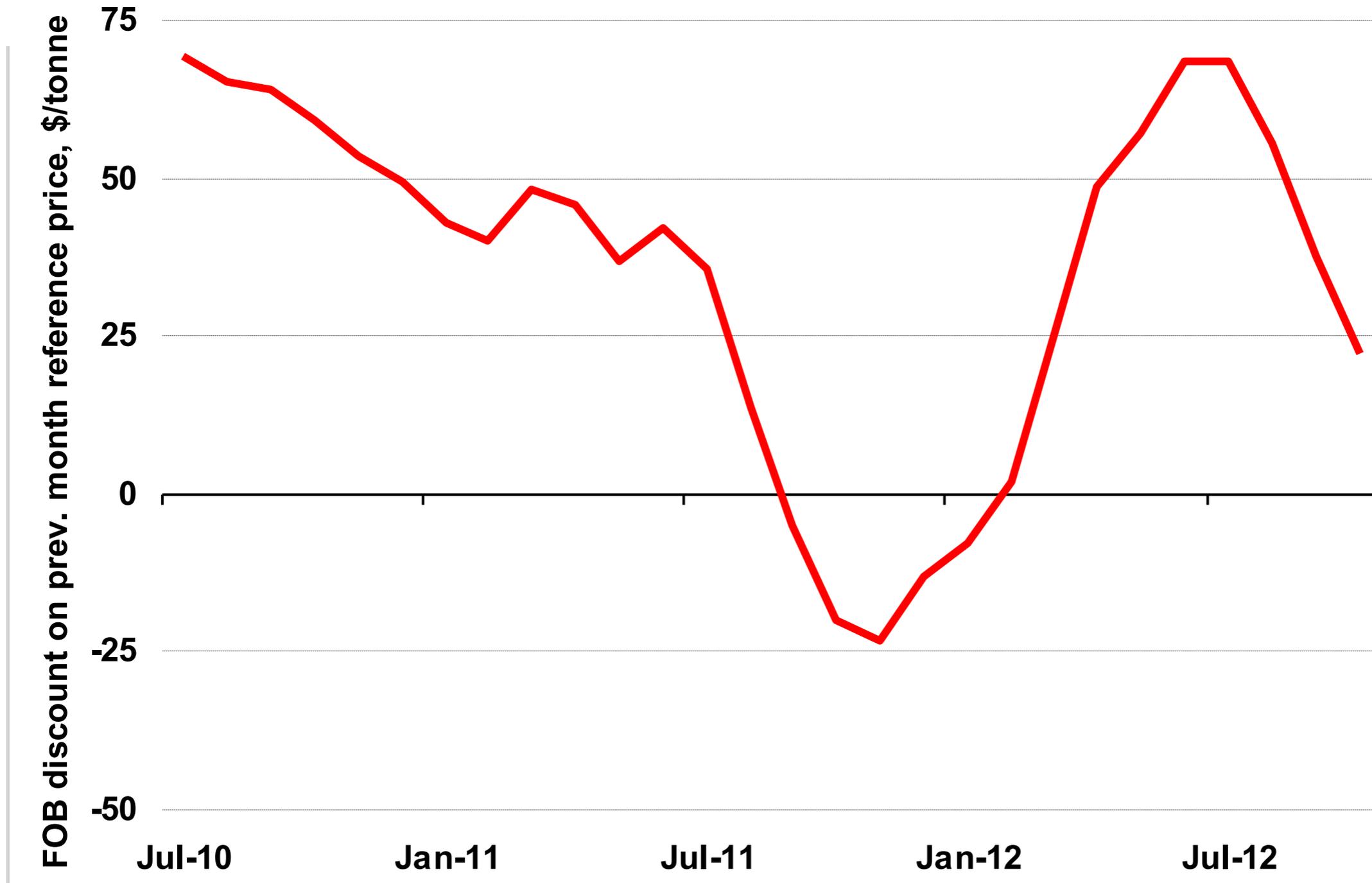
In other words, I will show you the advantage that would have been enjoyed by a biodiesel producer, for example, if the processor had been buying RBD palm oil at the RBD PO FOB price *minus* the export tax on the refined oil.

In practice, some integrated plantation companies give away potential profits on exports of RBD PO or of CPO when selling biodiesel. I examine this.

This illustrates the extra margins for Indonesian processors over their Malaysian rivals since the new export taxes were introduced last year.



Here I subtract freight from EU prices to deduce actual Indonesian PME export values and derive the discount on the official reference price.



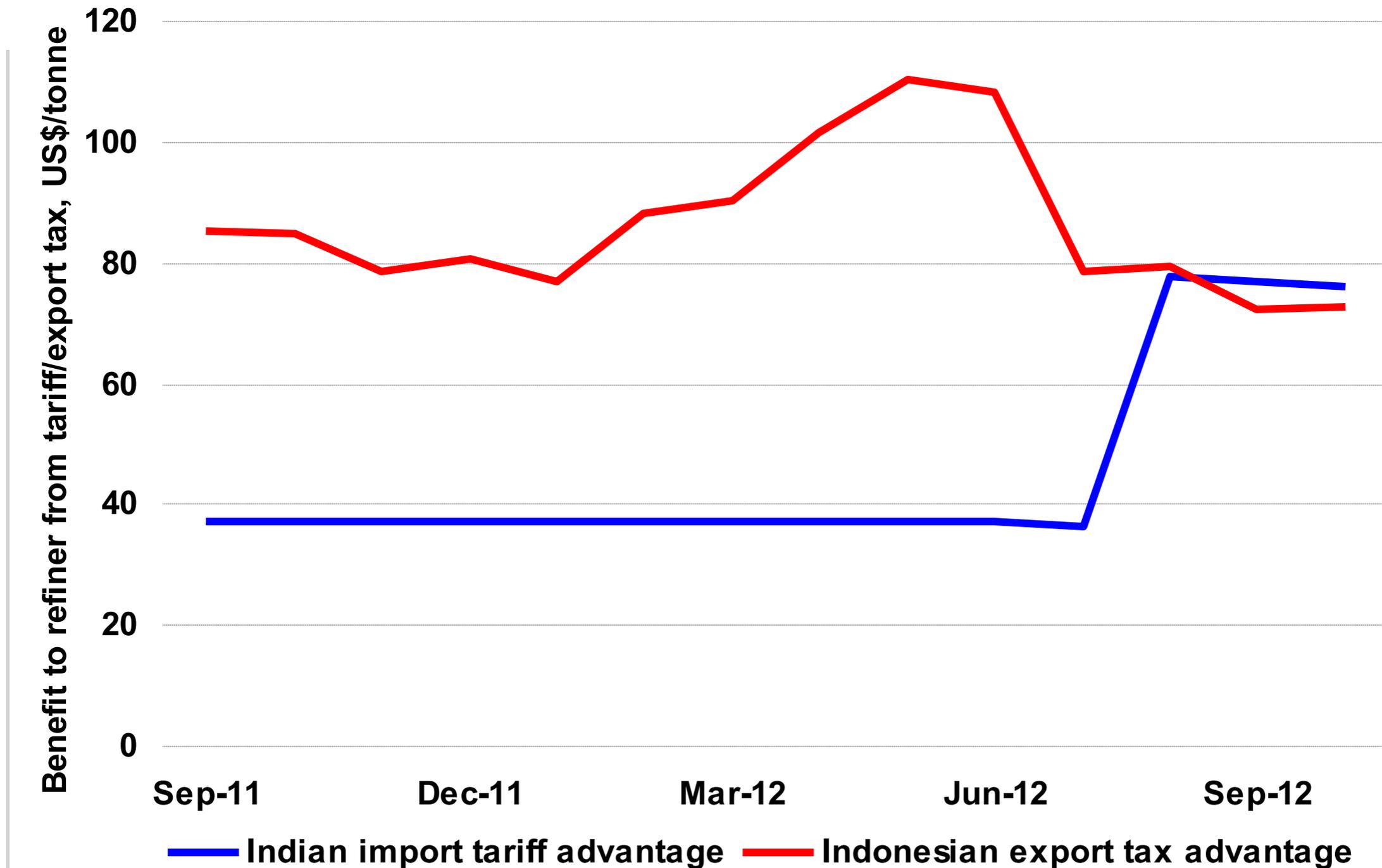
Indonesian exporters are discounting their downstream export sales of palm products

For a fairly widely traded product, such as palm methyl ester (PME), you can calculate what the landed price in the EU implies in terms of an FOB price in Indonesia, by subtracting freight costs.

When you do this (and smooth the series a bit), you discover that Indonesian biodiesel exporters have, on occasion, been willing to give up as much as \$70 per tonne of their savings on CPO or RBD PO costs (which arise by virtue of the export taxes on CPO or RBD PO) via discounts on their PME sales to the EU.

Malaysian exporters cannot hope to match this.

“If you can’t beat them, join them.” India reacted by raising the tariff values on RBD palm olein and boosting its own refining margins.



India almost exactly matched the benefit that Indonesian refiners enjoyed via the export tax reforms, but via import tariffs.

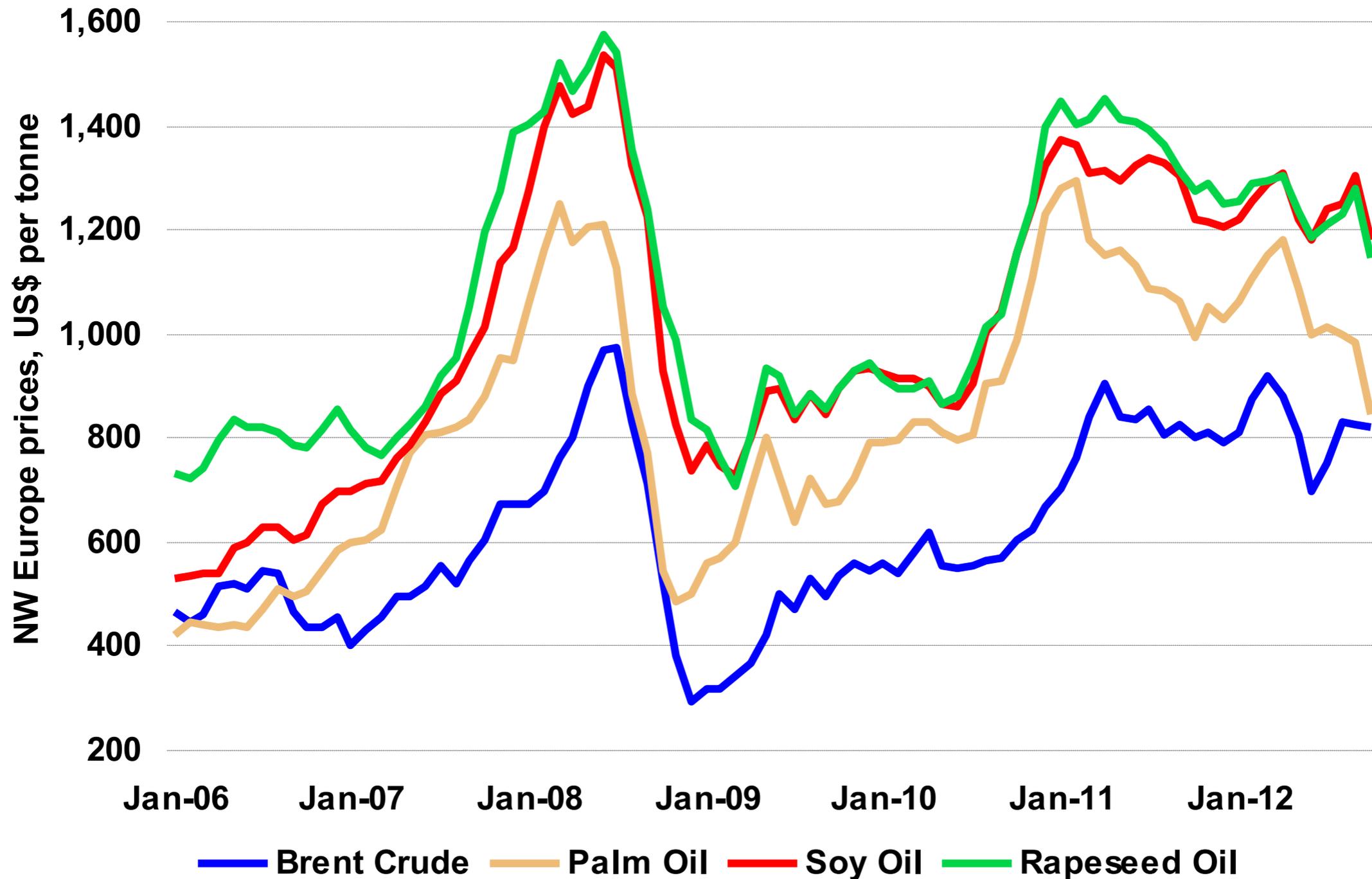
It is intriguing to see that, by chance I suspect, rather than design, the Indian system that adjusts the tariff values for RBD olein imports on a fortnightly basis has almost exactly matched the benefits provided to Indonesian refiners via its tax system that has been in effect for over a year.

The losers in all this are, once again, Malaysian refiners, unable to sell olein profitably to India.

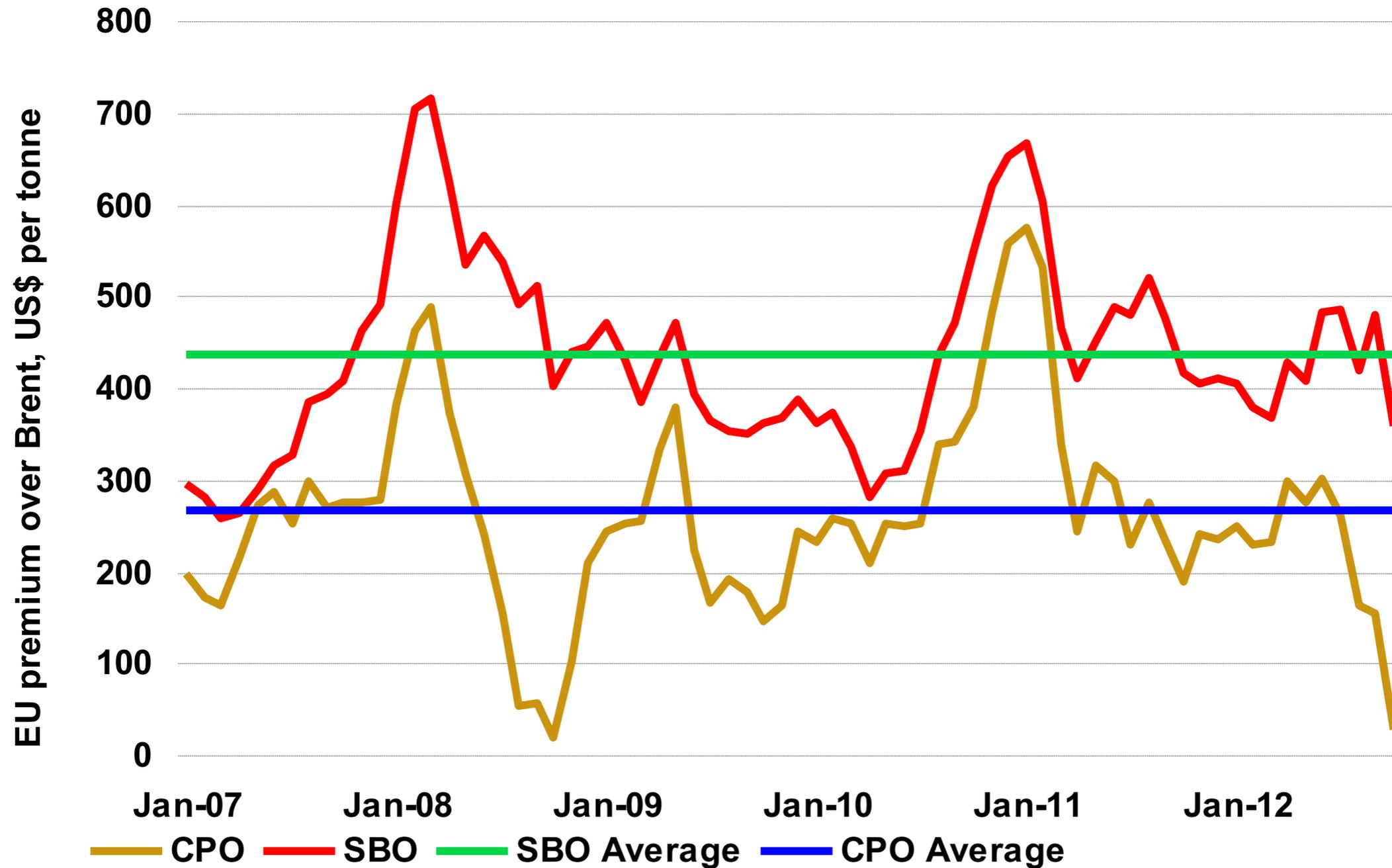
We see clearly why your government, confronted with record high stocks, had no real choice but to follow suit, as was announced last week.

The vegetable oil price band

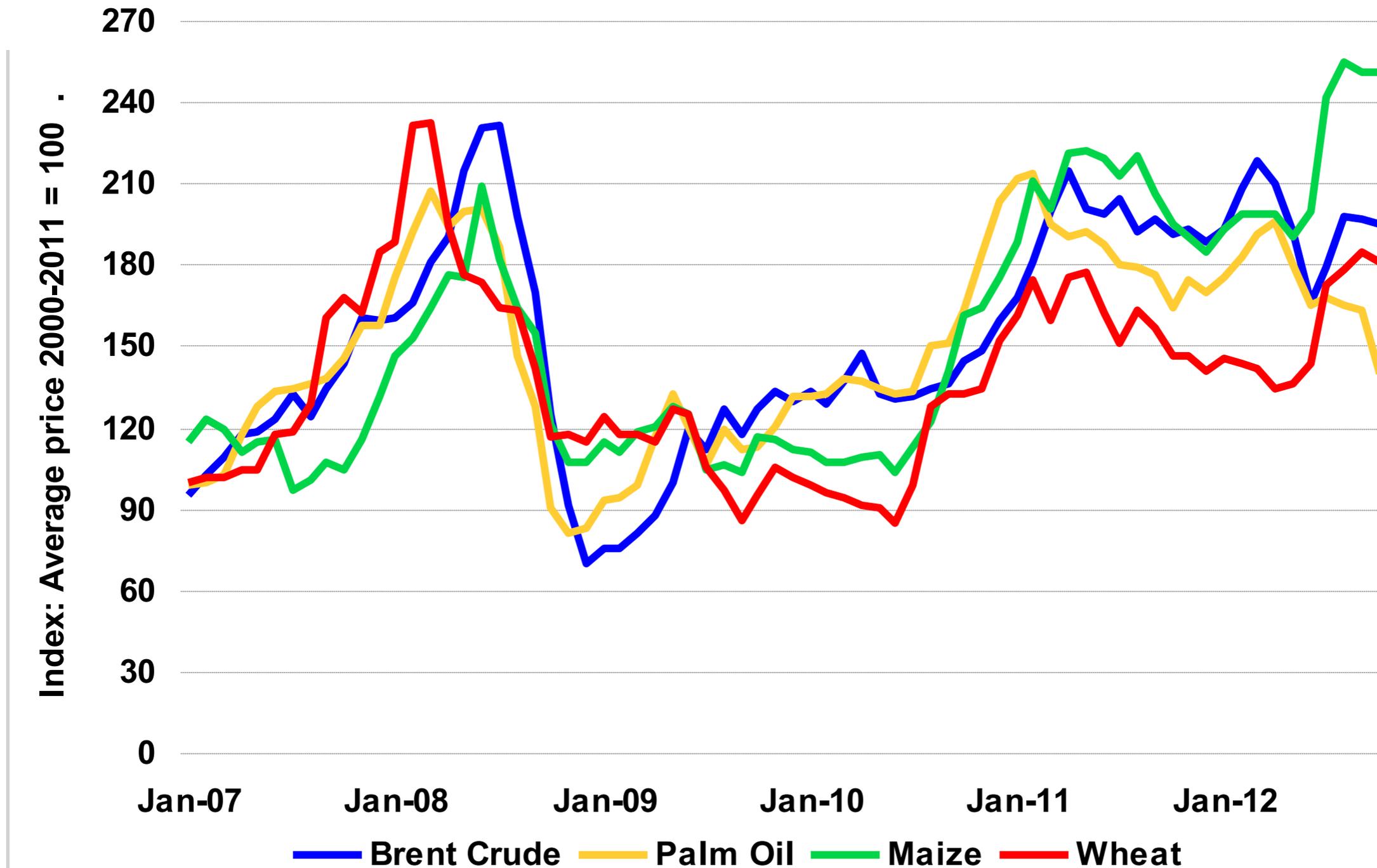
The price band linking vegetable oil prices to petroleum prices is still alive and well.



Here I plot the premia for the major oils over the Brent price. We can see a repeat of 2008 here.



Note that the price band extends to other crops, e.g., grains, thanks to the influence of biofuels.



Implications of the price band

Once we understand that the price band exists, we should focus our attention upon the differentials between vegetable oil and crude oil prices in the development of price forecasts.

This requires a significant change in the way in which we analyse the impact of the supply-demand balance and stocks upon the level of vegetable oil prices.

When vegetable oil prices approach that of crude oil, the production of biodiesel and the direct burning of vegetable oils become increasingly attractive options. This creates the floor to the price band.

When vegetable oil prices get too far above crude oil, biofuel demand drops, creating the ceiling to the band.

The impact of stocks on prices

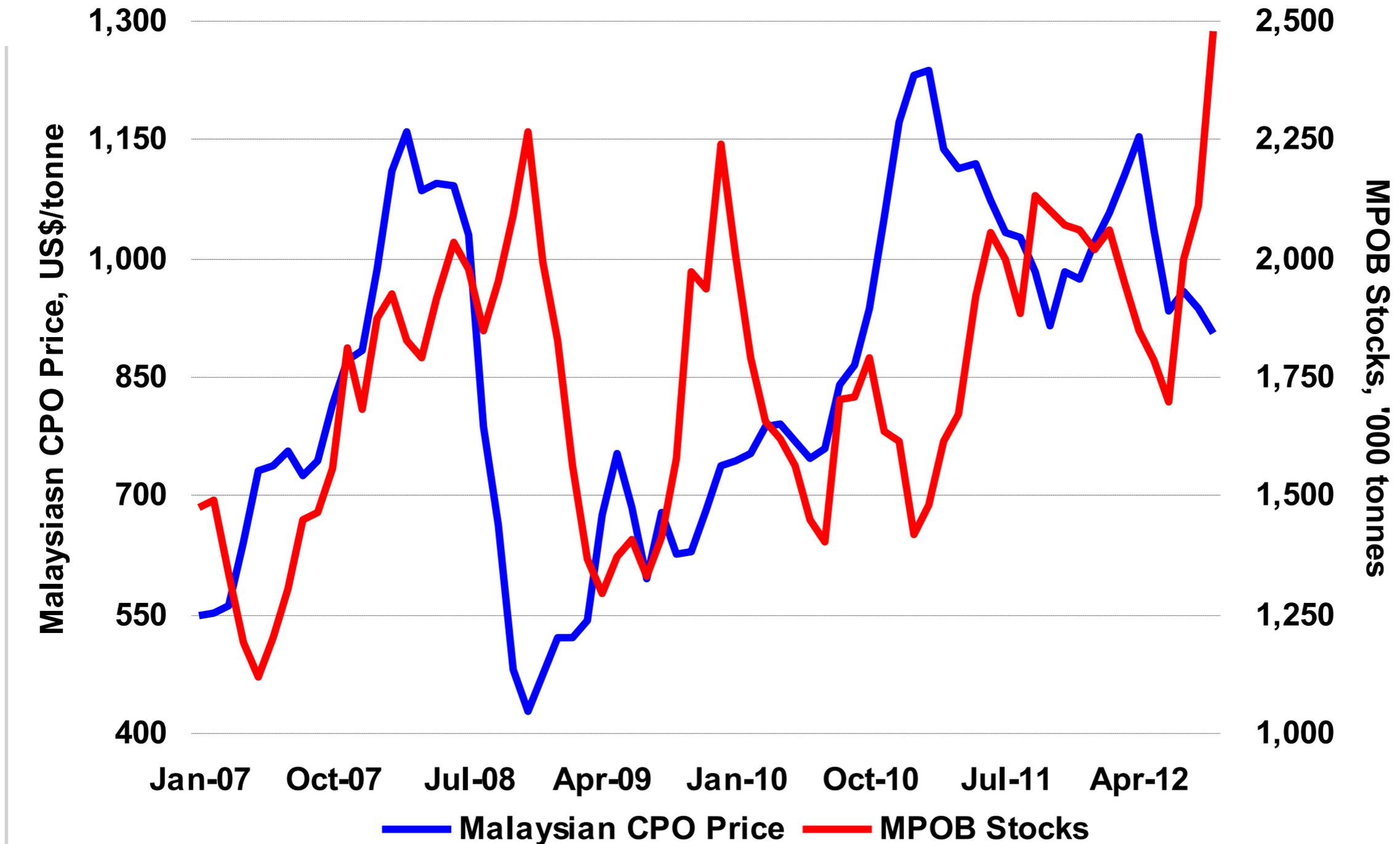
The significance of vegetable oil stocks

Palm oil plays a crucial role in the determination of prices in the vegetable oil complex, and not only because it is the world's largest source of oils.

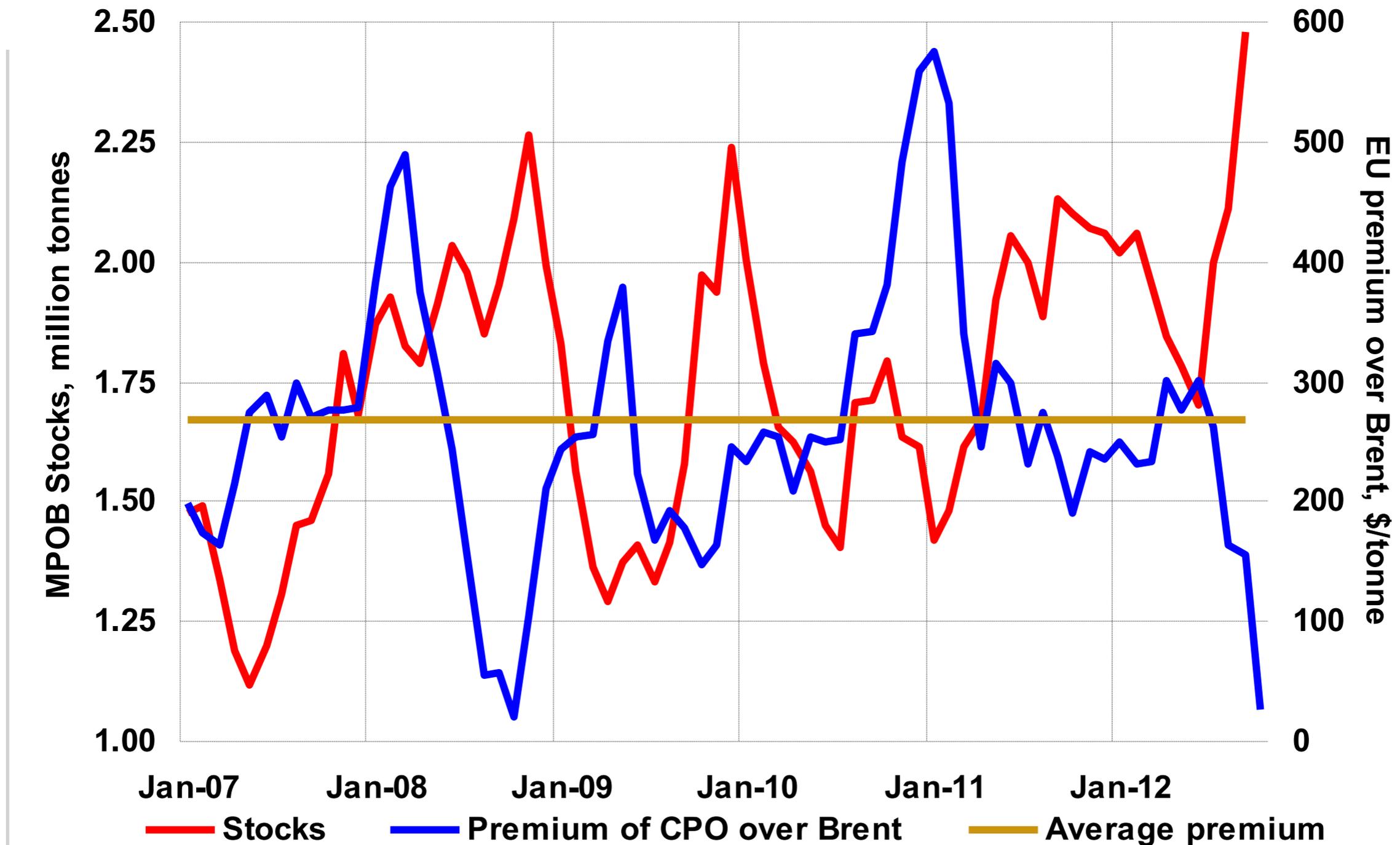
Unlike the oils produced by crushing soybeans and rapeseed, for which crushers only decide to produce oil and meal if there is a demand for the end-product, palm oil has to be produced every day, since the oil palm fresh fruit bunches cannot be stored.

As a result, mill tanks fill every day (oil palm is a year-round crop) and palm oil producers with high stocks act as distress sellers. This explains its permanent discount on other oils and the recent sharp drop in palm oil prices after a surge in S.E. Asian output.

There is no simple relationship between palm oil stocks and prices. High prices are found at times of both high and low palm oil stocks.



With the price band in place, we should now be studying the relationship between the palm oil premium over Brent crude and palm oil stocks.



We must incorporate the price band into the analysis of the relationship between palm oil stocks and CPO prices

We surely all agree that high stocks should be linked in some way to low prices and *vice versa*.

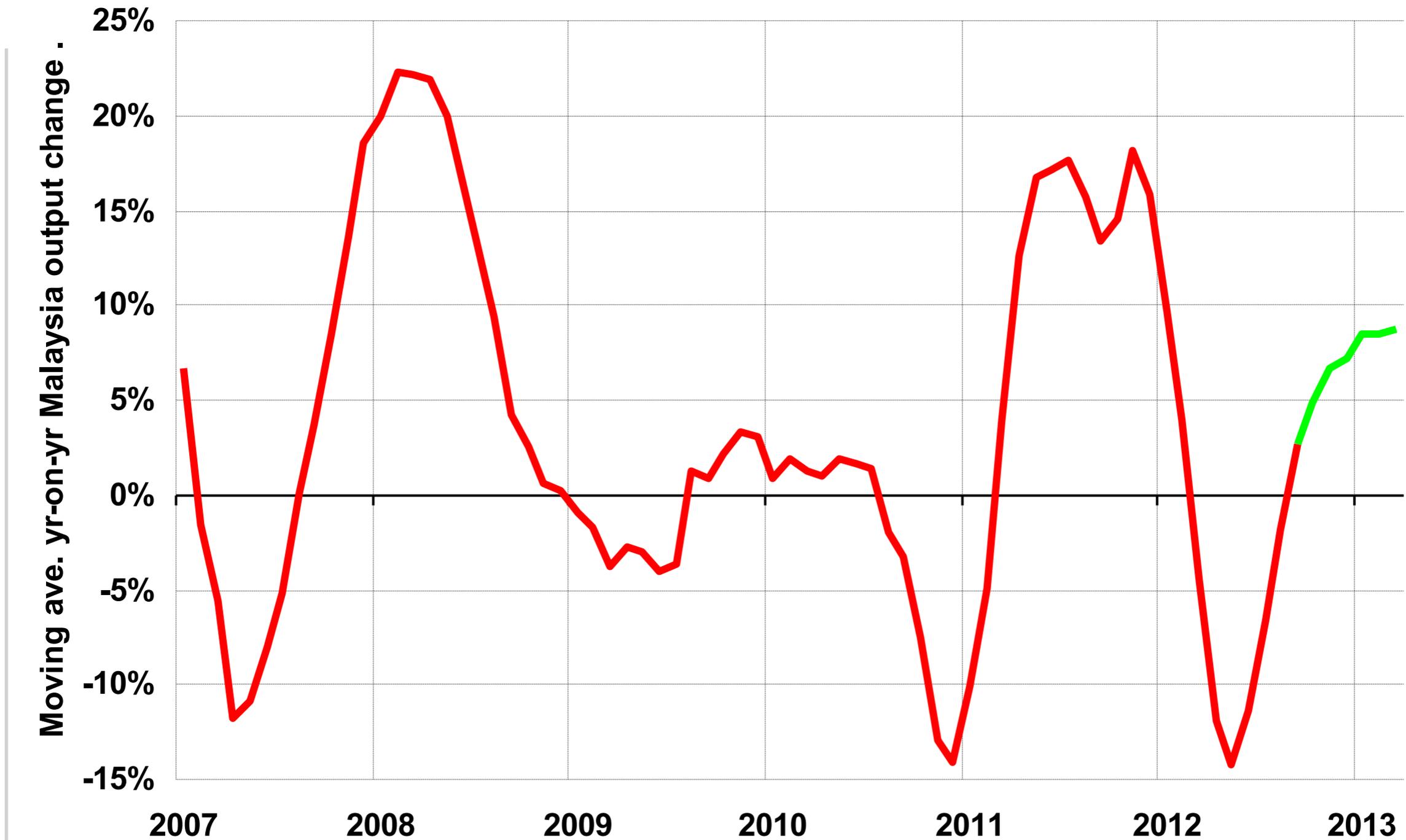
However, now that we have price bands, the evidence is that high stocks are linked to a low CPO premium over petroleum and *vice versa*.

When stocks of oils are low, food users compete with biofuel for these supplies and this pulls up the premium. When stocks are high, the premium falls back and this boosts biofuel demand for oils.

The monthly stocks that the market follows are those released by the MPOB.

Short run prospects for palm oil

Forecasts of Malaysian CPO output imply that year-on-year declines will now be followed by recovery, as the tree's biological cycle unfolds.



The prospects for palm oil output growth

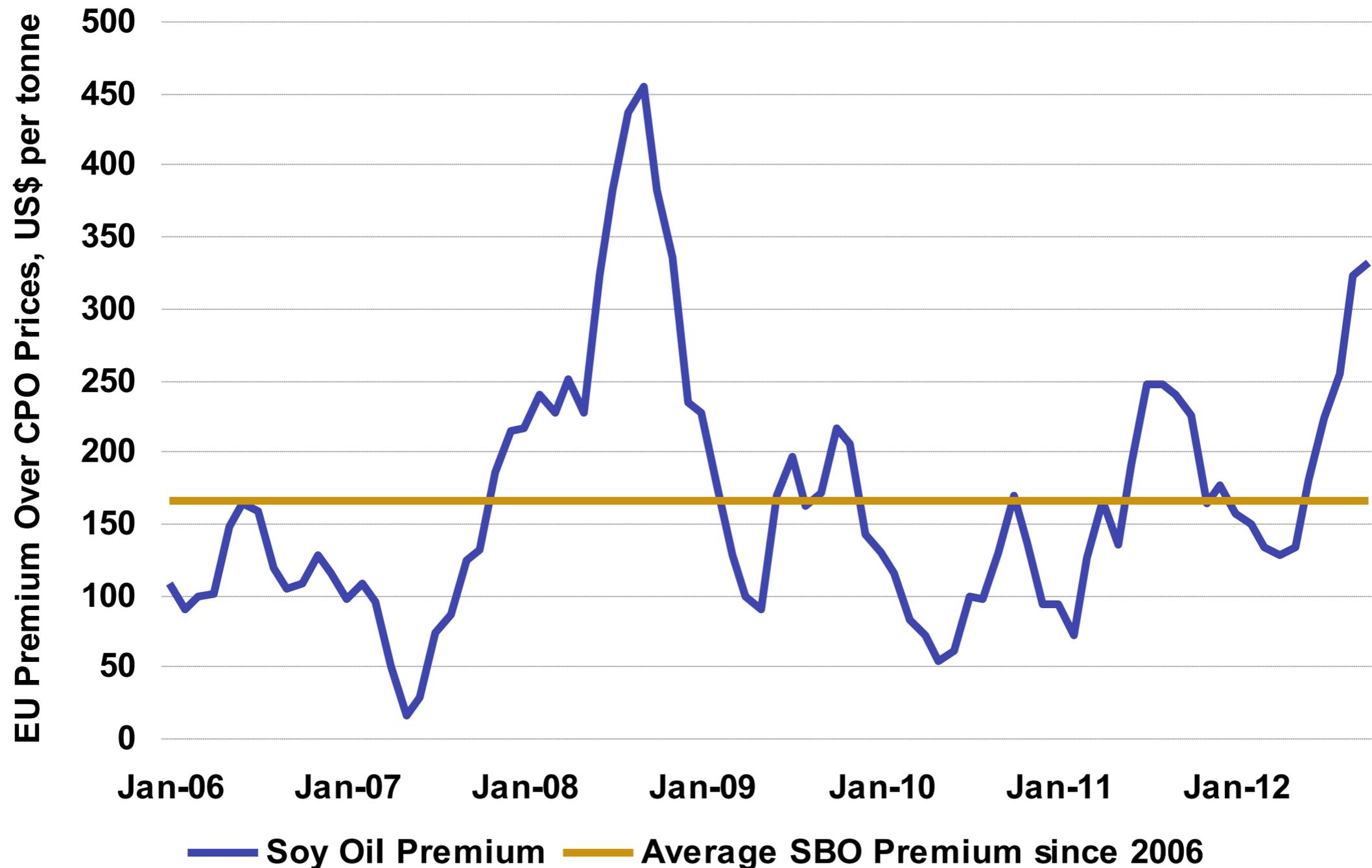
2011 was a remarkably good year for CPO output all over the world from S.E. Asia to Latin America.

2012 output is now benefiting from the good rains in most regions in 2011 and early this year, but there is still a legacy of dry conditions in a couple of Indonesian regions.

Most important is the growing confirmation that, regardless of pressures to slow the development of new oil palm estates, high prices have done their job of promoting investment in new capacity.

Since oil palms take three years to start producing and eight years to reach peak output, we can expect a rising wave of Indonesian palm oil output.

In the background, the soy oil premium vs. CPO is getting very high, but not as high as in 2008.



Export taxes and vegetable oil prices

Prospects for Malaysian stocks are inextricably linked to events in Indonesia, where production is surging and the 2011 export tax reform is promoting exports of refined oils, traditionally Malaysia's domain.

After over a year of hesitating, your government has finally reacted with its own export tax reform. This, together with the emergence of price-sensitive biofuel demand, should stop stocks rising from December, pulling up the premium for palm oil over Brent crude.

At that time, as S. American soybean crops approach, the soy-palm oil premium should shrink; but more important than all these influences is knowing when Brent crude finally falls back to more sustainable levels.

Thank You



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