

# POTS Karachi, January 2014

What have we learned from palm oil markets in 2013 and what does this tell us about prices today?

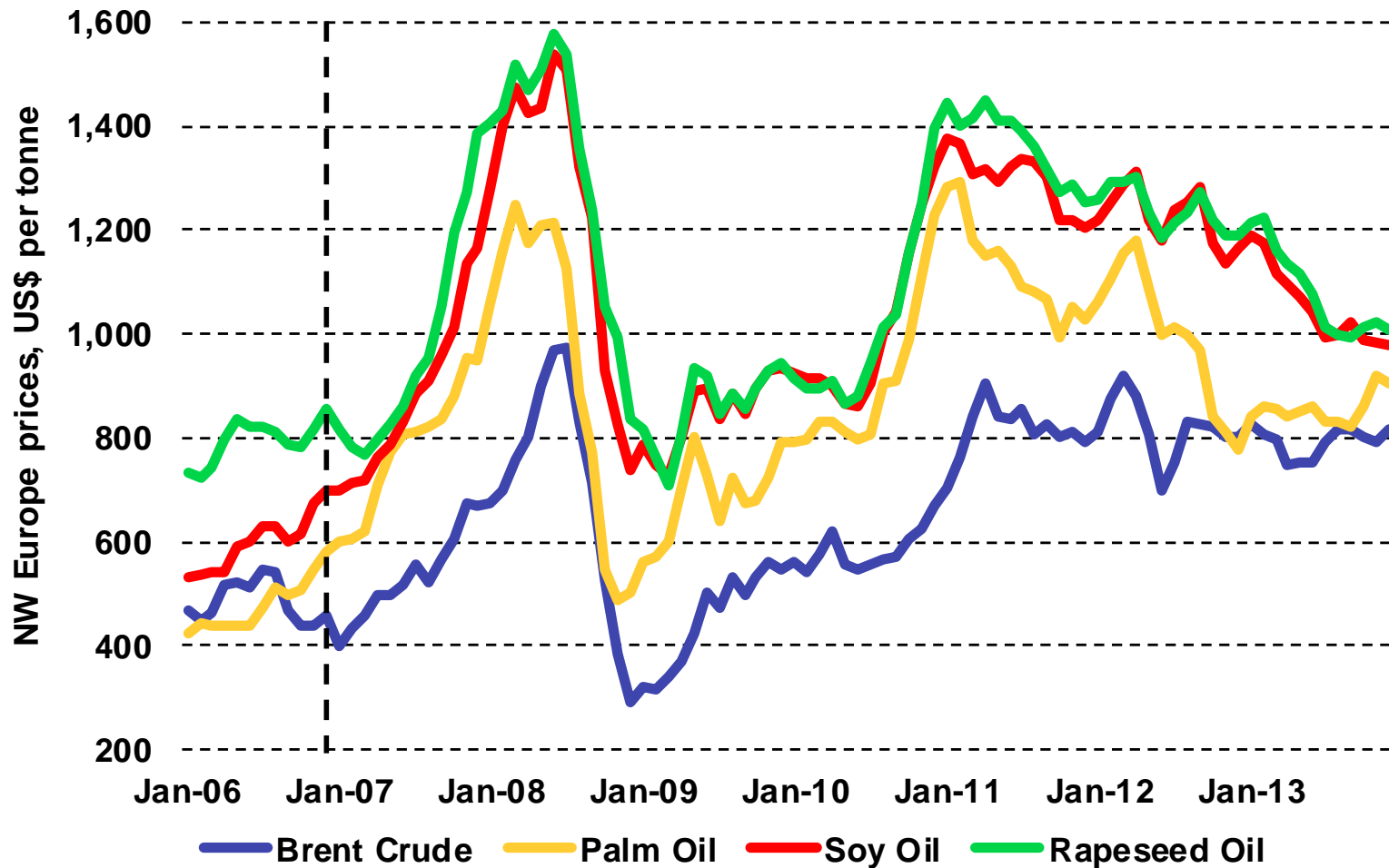
David Jackson, LMC International



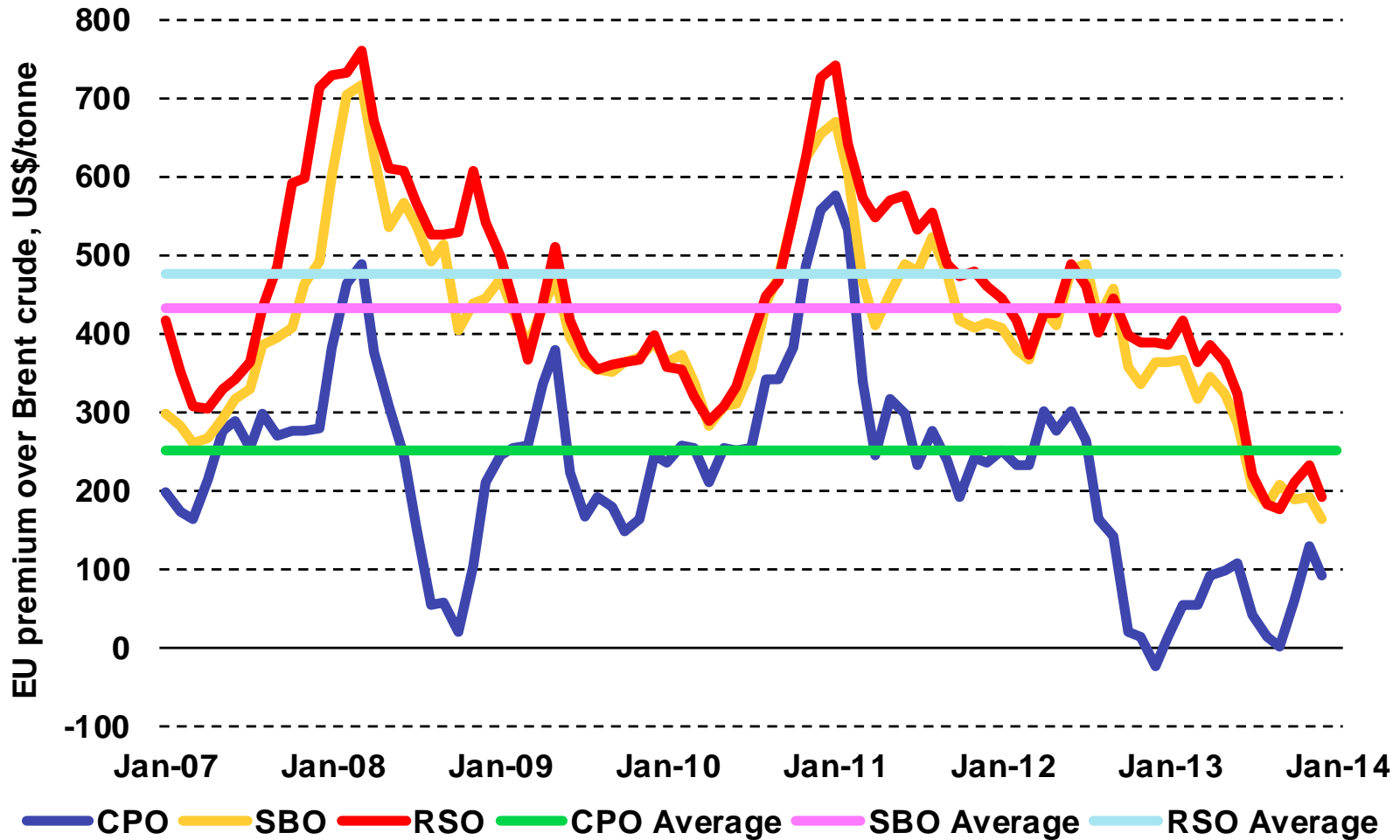
# The price band has survived its big test



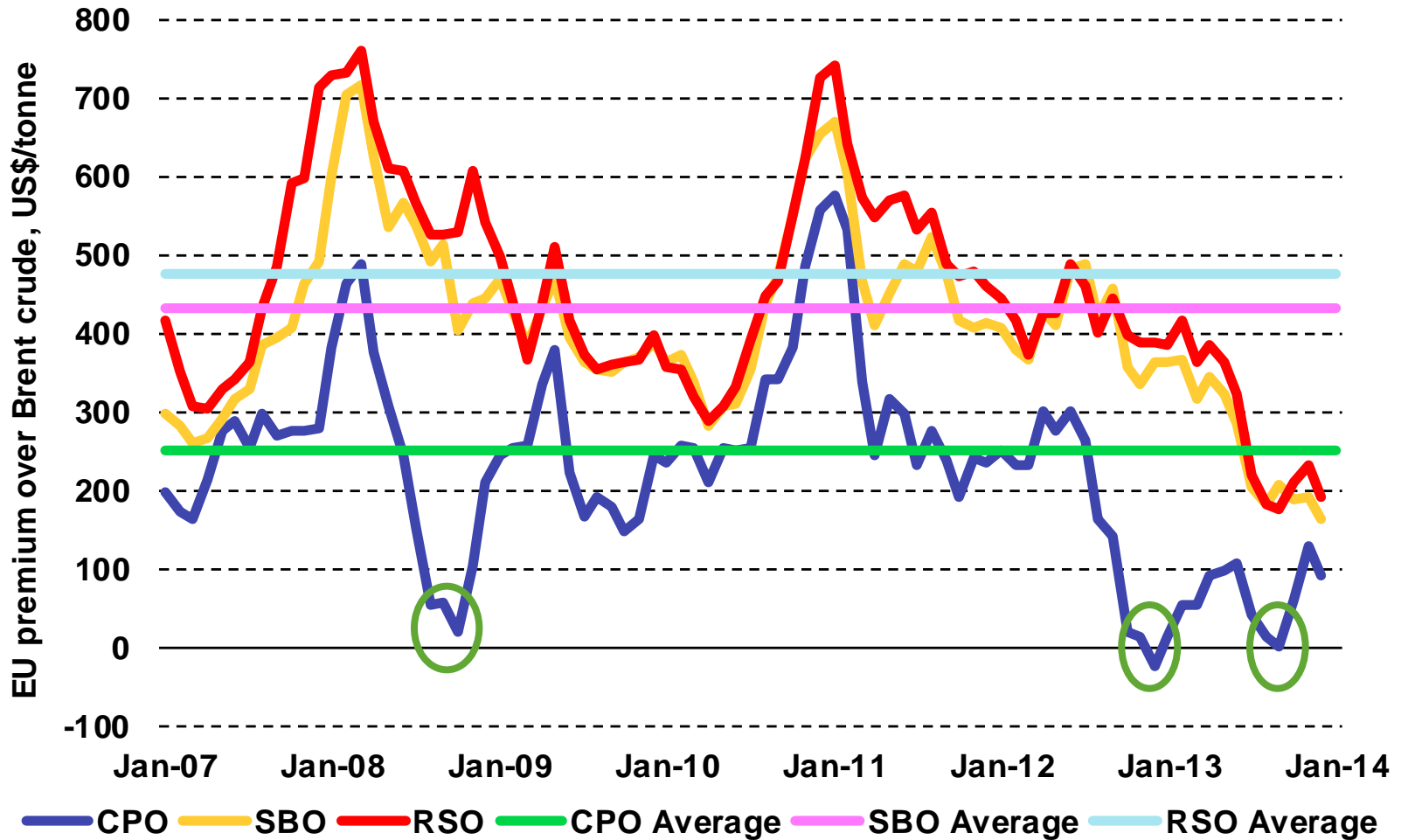
Since 2007 EU vegetable oil prices have been tied to petroleum prices within a clear price band.



The price band means that attention should now focus on differentials inside the band. Here are the premia of three main oils vs. Brent crude.



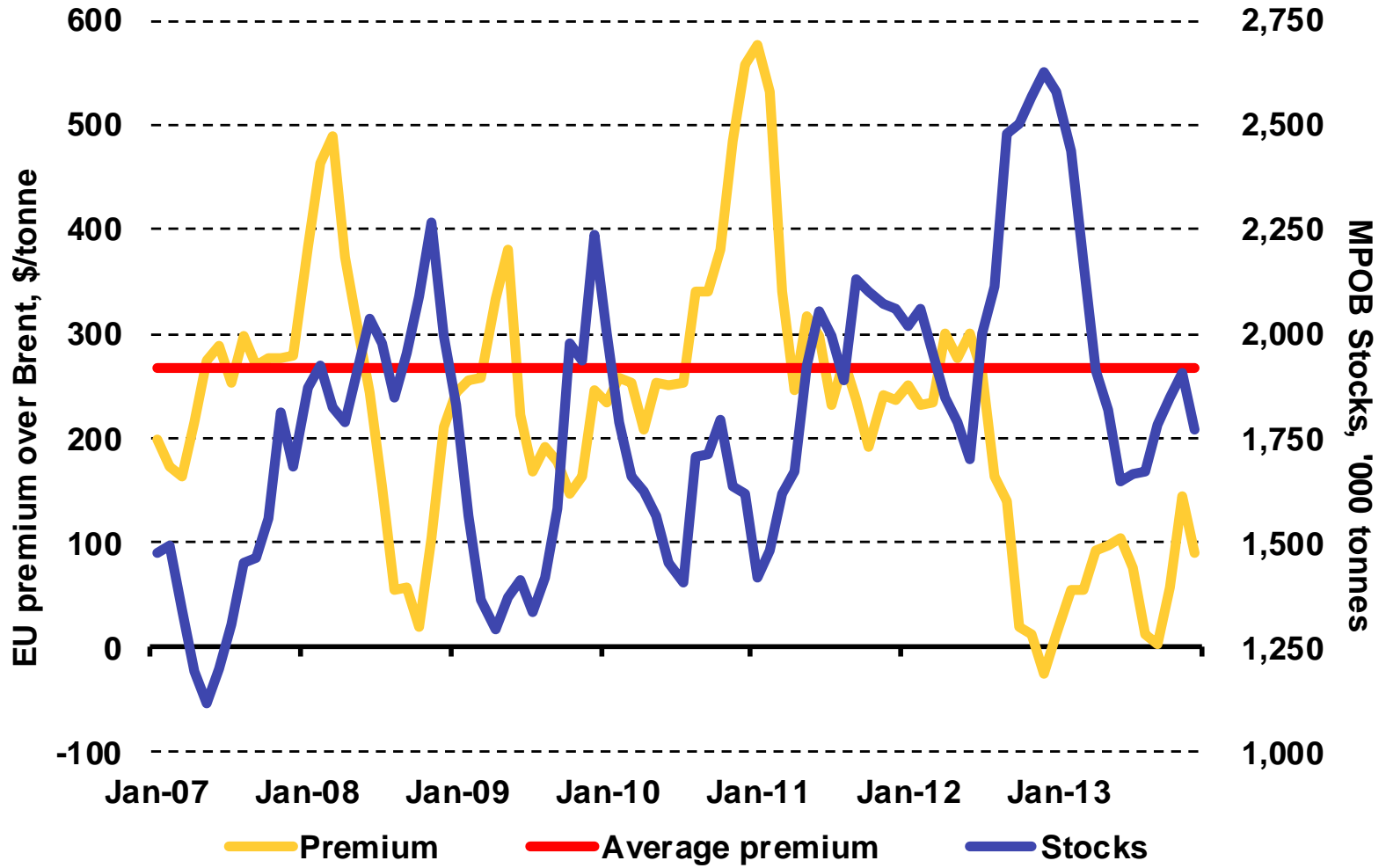
September 2013 was the third time that the premium for CPO fell to zero, i.e., the EU CPO price was equal to the Brent crude oil price.



What determines the premium for vegetable oils over Brent crude?



# Answer for palm oil: its premium vs. Brent moves in the opposite direction to Malaysian stocks.

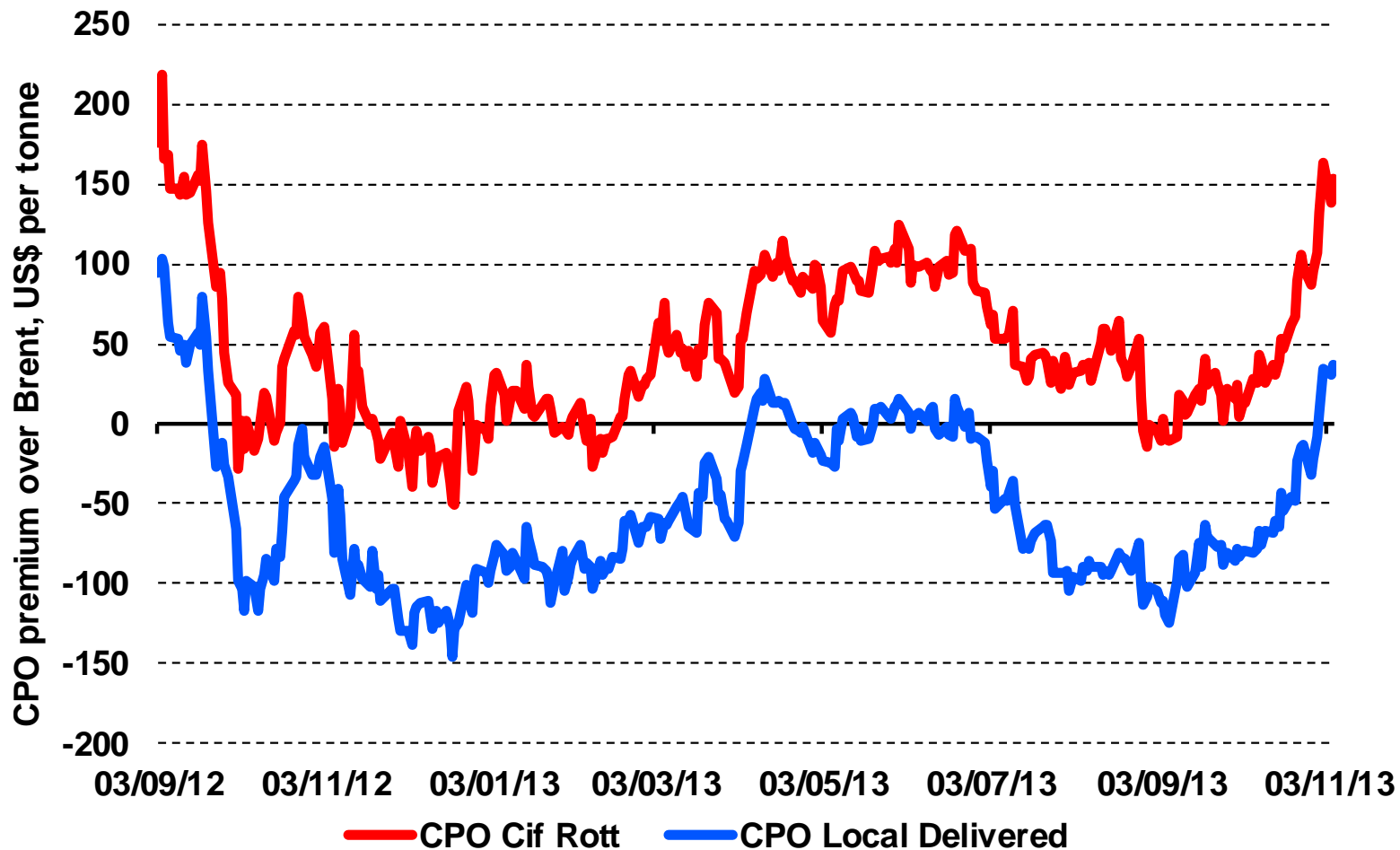


How does the price floor hold firm in the face of the pressure of stocks?

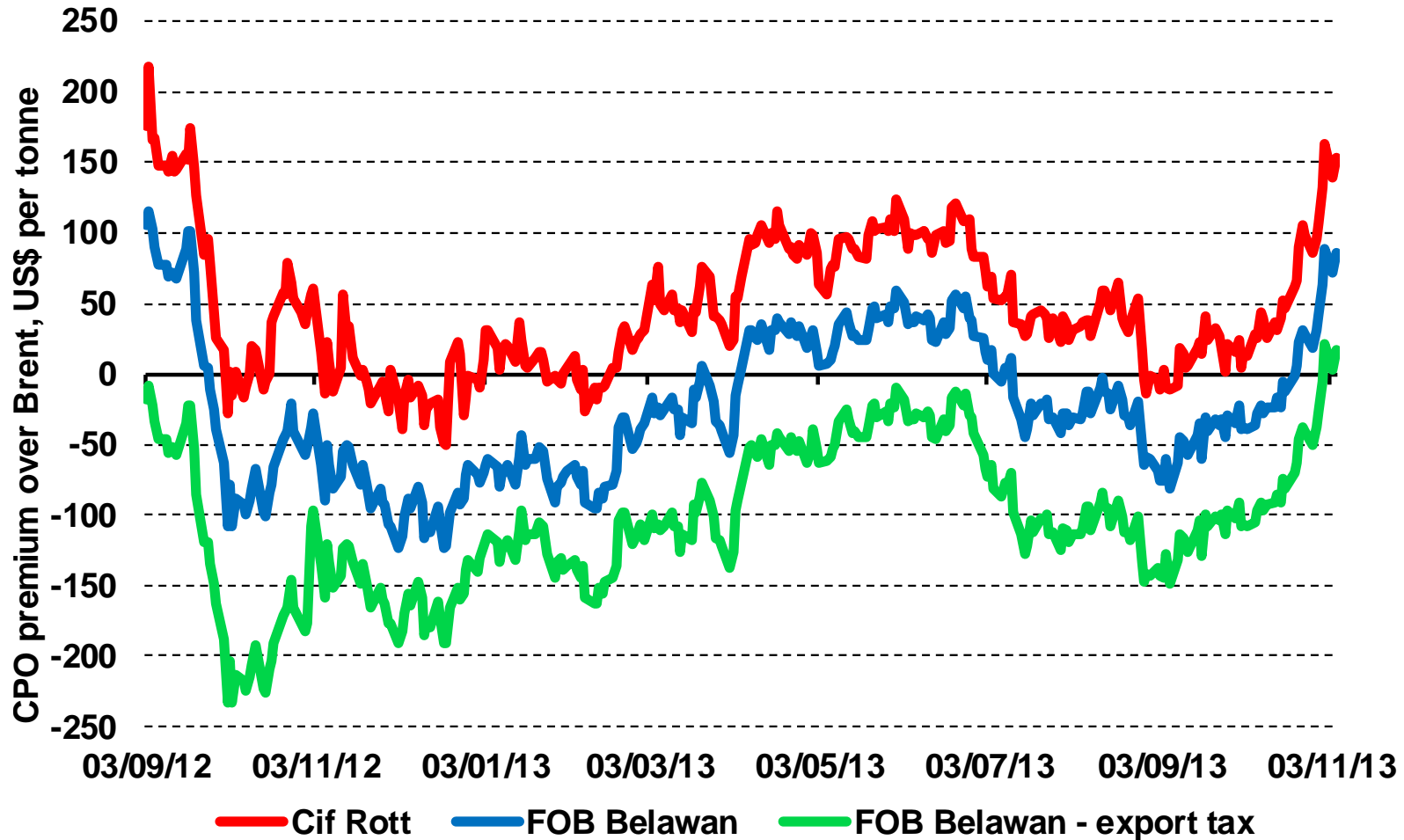




At the zero premium floor to the EU price band, CPO in S.E. Asia is cheaper than Brent. See EU (red) and Malaysian (blue) premia over Brent.



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



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

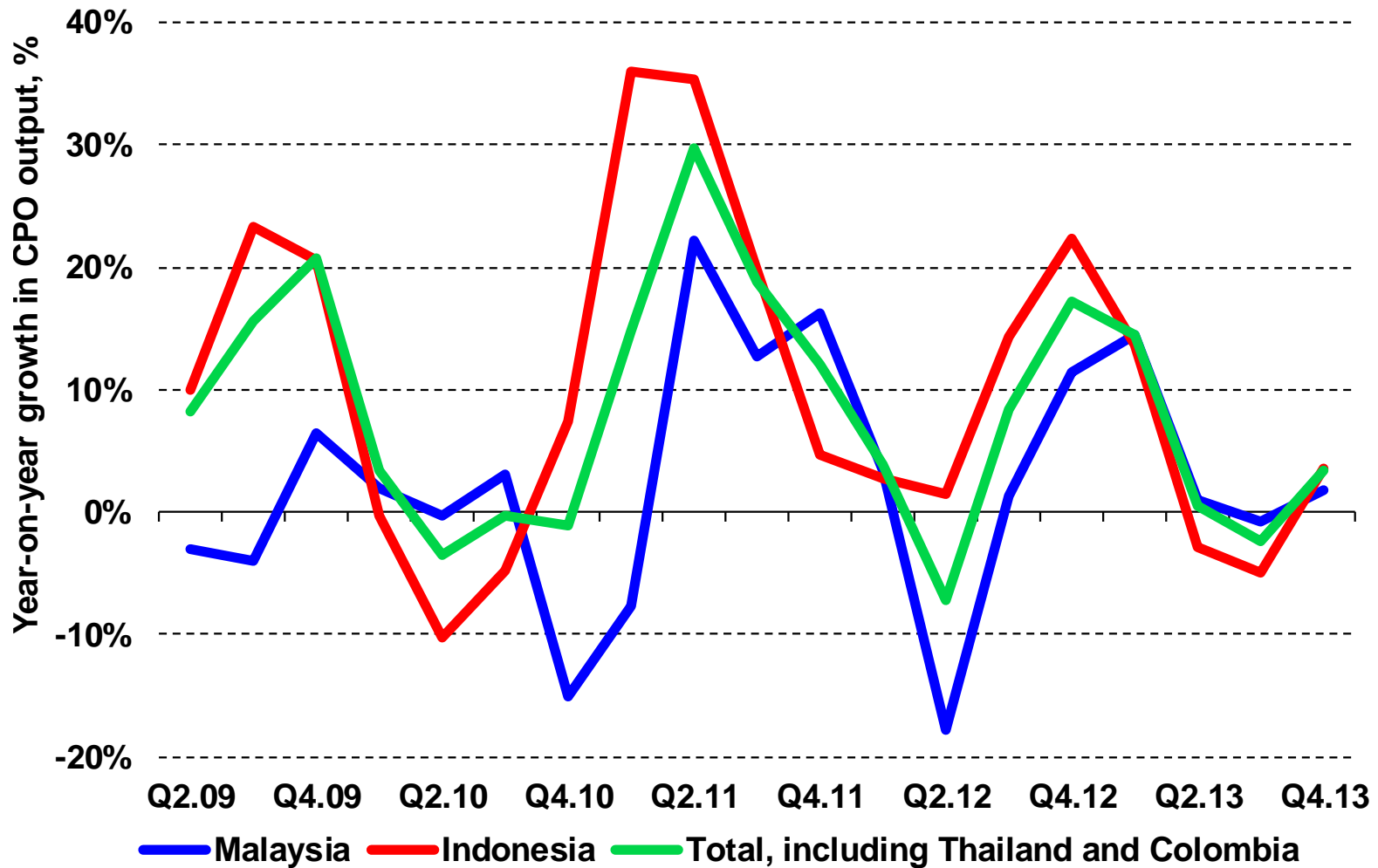
Freight costs from S.E. Asia translate the floor to the EU price band (where CPO prices equal Brent crude prices) into an FOB CPO discount on crude oil in S.E. Asia.

Export taxes in S.E. Asia have reinforced the economics of turning CPO into biofuel for use in the region.

There is no doubt that, at the floor to the price band, vegetable oils are competitive liquid fuels in S.E. Asia.

The large increase in Indonesia's biodiesel mandate suddenly added \$120 to the CPO price in Q4 2013.

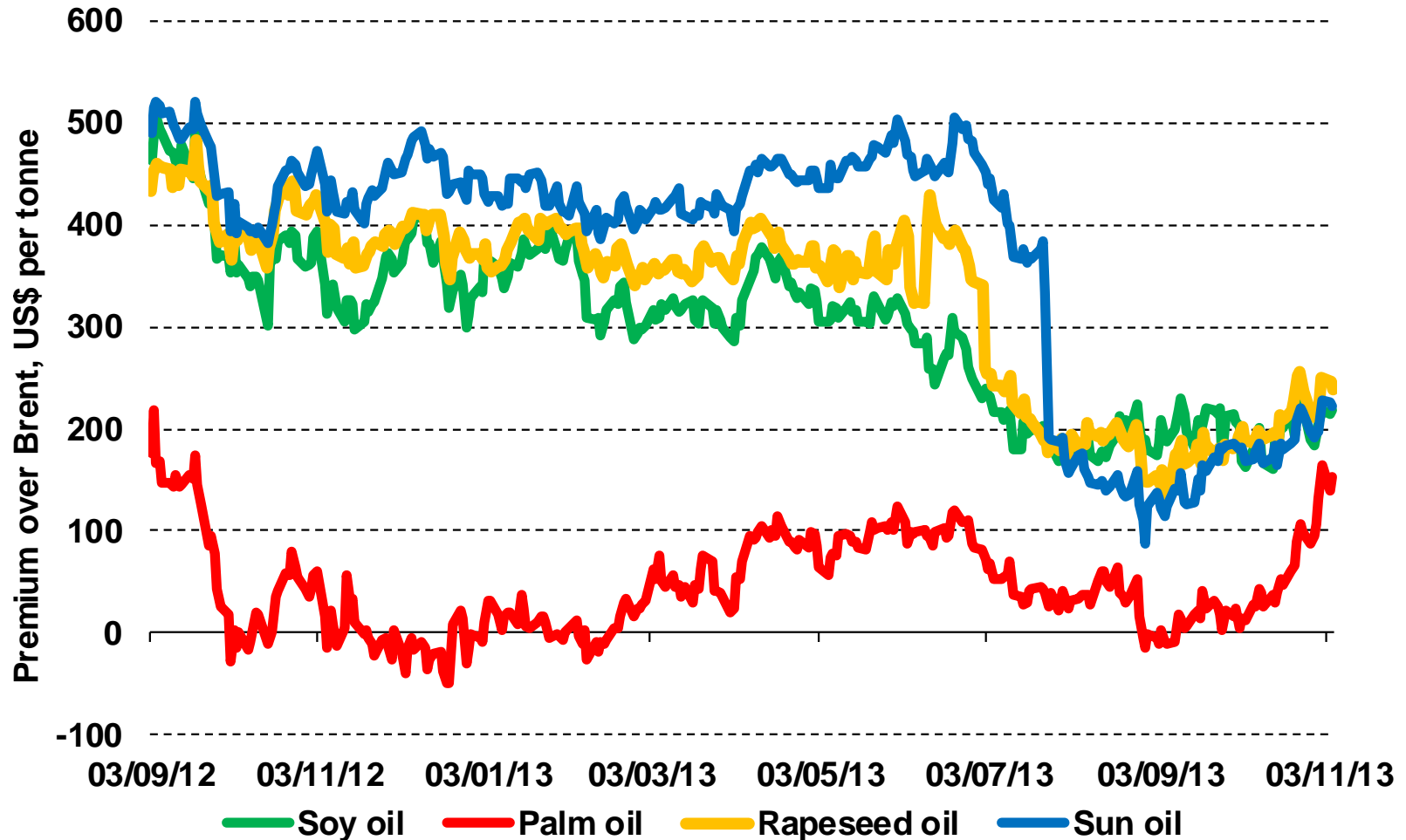
This was assisted by CPO year-on-year output, where growth has been slower than expected, notably in Indonesia.



If palm oil producers have been the winners, who have been the losers?



The main losers are the seed oils. As EU and US support for biofuels has eased, strong CPO prices will have to underpin seed oil prices.



# Biofuels will play a crucial role in the balance between oilseeds and palm



# Palm biodiesel demand is about to soar

The lead in the use of palm biodiesel has so far come from relatively small oil palm producers, Colombia and Thailand.

However, that is about to change. Malaysia is gradually moving up to a national B5 mandate.

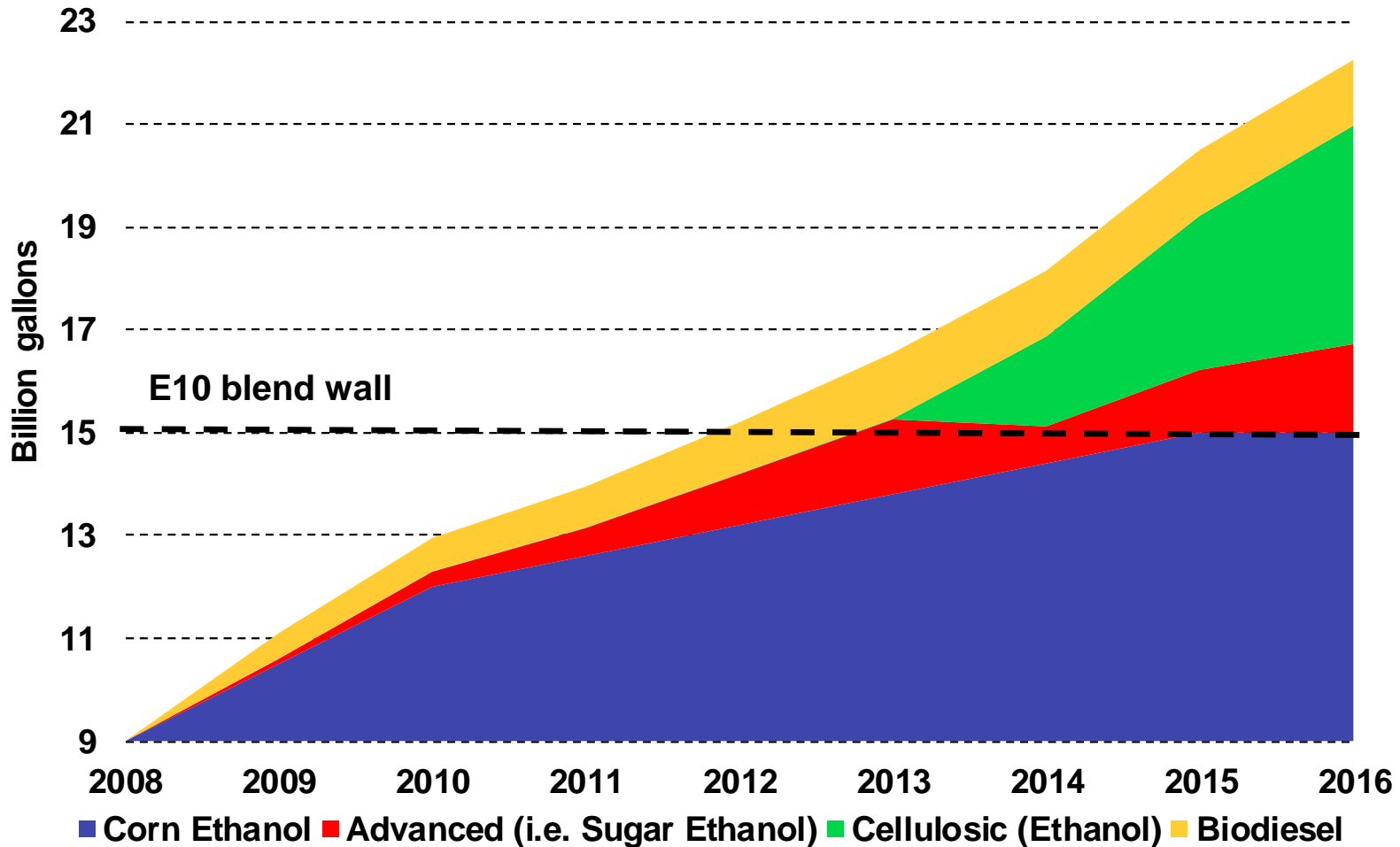
The breakthrough in palm biodiesel demand is in Indonesia. Export taxes generated a free market demand for palm biodiesel, but the government has now announced a B10 mandate starting this year, with Pertamina, the state oil company, buying 3 million tonnes/year of palm/palm stearin methyl ester.



US and EU biofuel policies are slowing the demand for seed oils. (a) The US



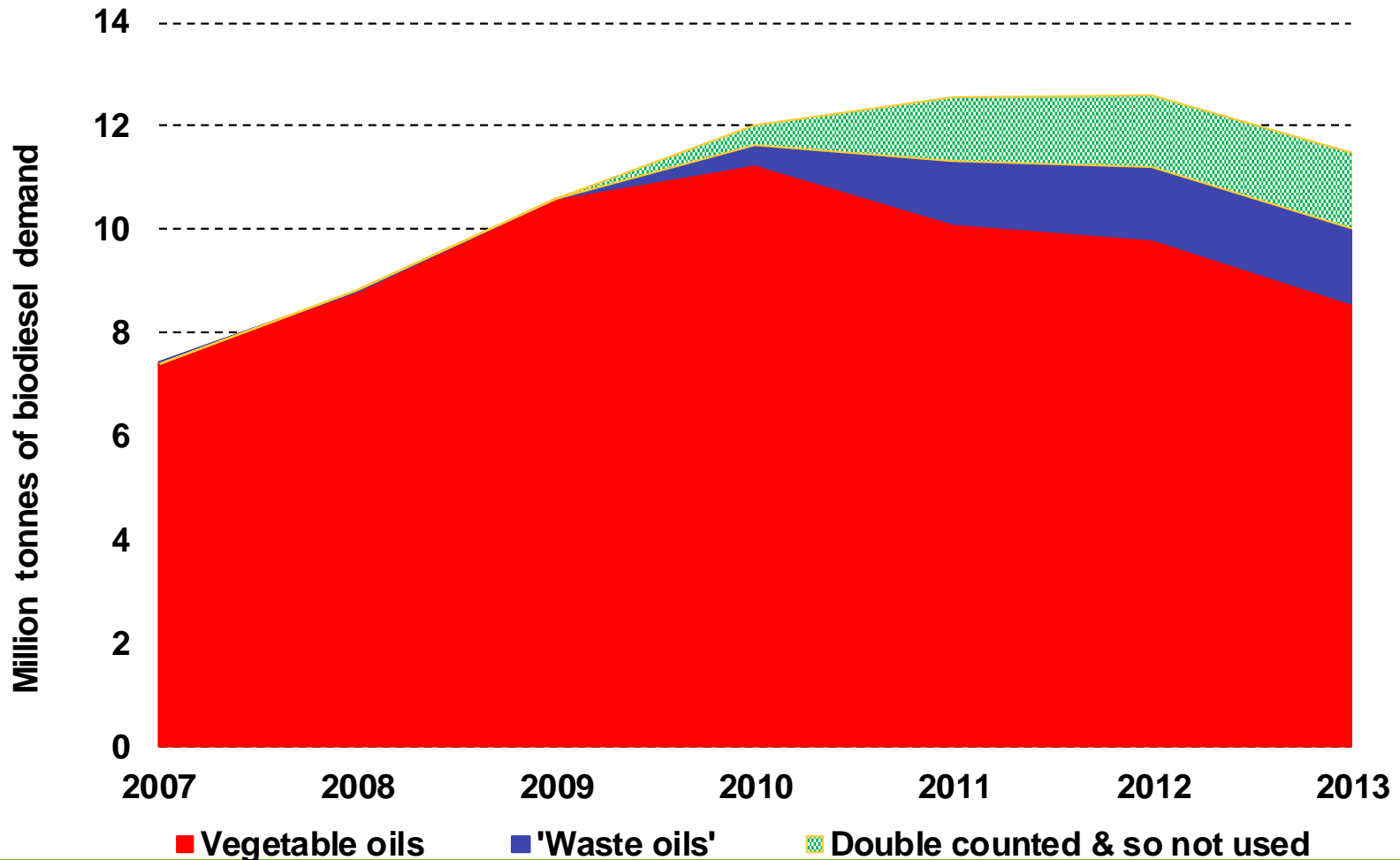
The US ran into an ethanol blend wall, making it impossible to meet renewable fuel mandates. As they are cut back, biodiesel will suffer, too.



US and EU biofuel policies are slowing the demand for seed oils. (b) The EU



EU support for biofuels is falling, causing a cutback in EU targets; the “double counting” of waste oils is hitting biofuel demand for oils.



# Weakening EU and US enthusiasm for biofuels will not end the price band

Different reasons (technical and political) lie behind the slowdown or fall in biofuel demand in the US and EU.

However, this coincided with a sharp rise in S.E. Asian biodiesel demand, led by Indonesia, and the temporary emergence of a new form of demand for biodiesel as a cheap fuel in imports of biodiesel-diesel blends into China.

Therefore, the geographical balance of biofuel demand is shifting, but changing government policies on biofuels will not affect the future relevance of the price band.

The scope to use palm oil as a cheap fuel is now well known. That knowledge is just as relevant for the seed oils; therefore, every time prices approach that of crude oil, free market biofuel use should create the price floor.

# The prospects for prices in 2014

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We have a puzzle. Palm oil stocks are not high. Yet prices are still relatively weak.

For palm oil, Action by Indonesia to boost biodiesel use should help to pull down stocks and lift the EU palm premium over Brent.

The seed oils have enjoyed a long period of rising local biofuel mandates to lift their prices; but.... support for biofuels is definitely slipping in both the EU and US.

As a result, just when palm oil producers are getting help from higher local biodiesel sales, we are witnessing a structural change in seed oil markets.

They will have to learn from palm oil and compete more directly with petroleum to make extra sales of biodiesel.

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

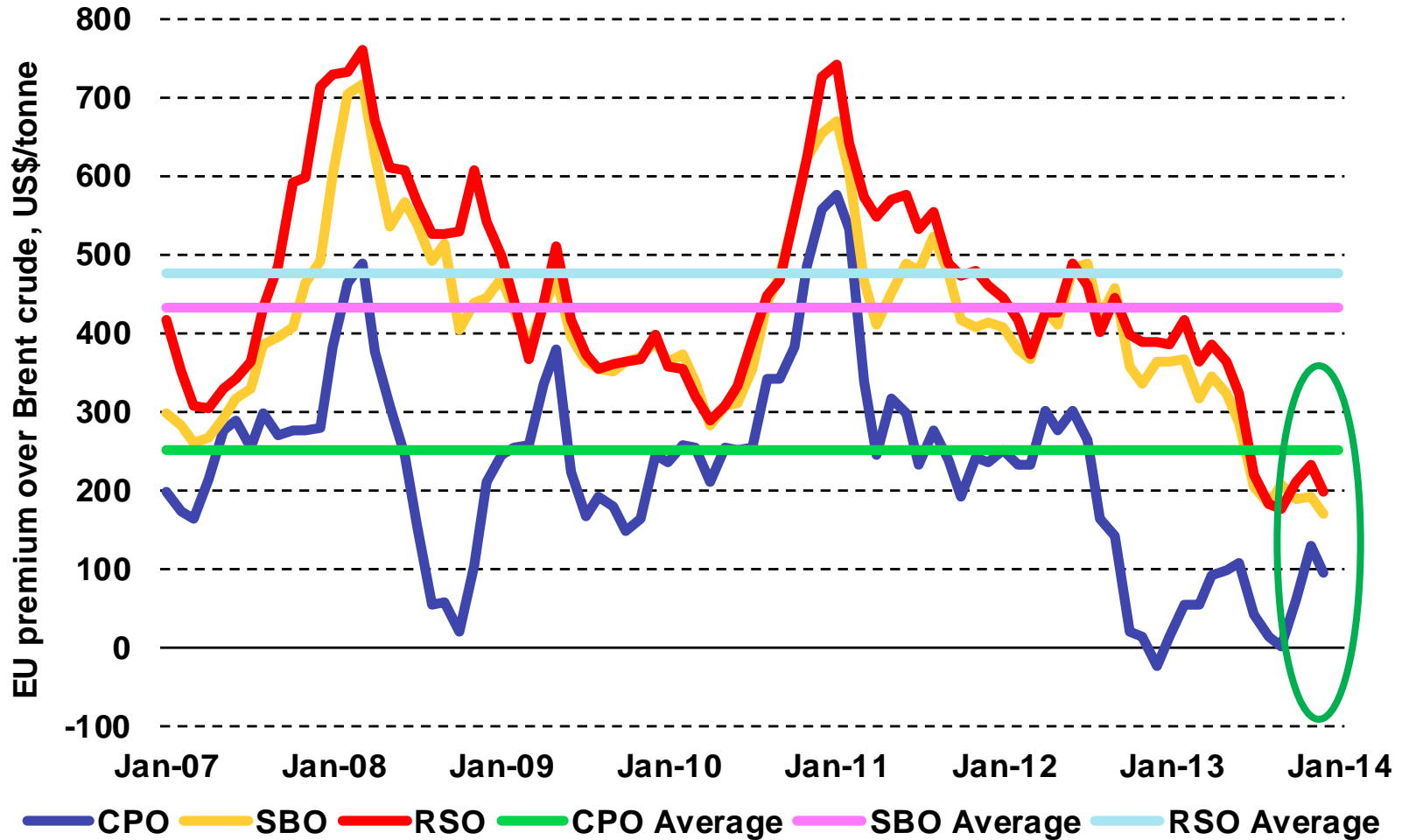
It may sound paradoxical, but the weakening of the support for biofuels may force all vegetable oils to become more than ever part of the petroleum complex.

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

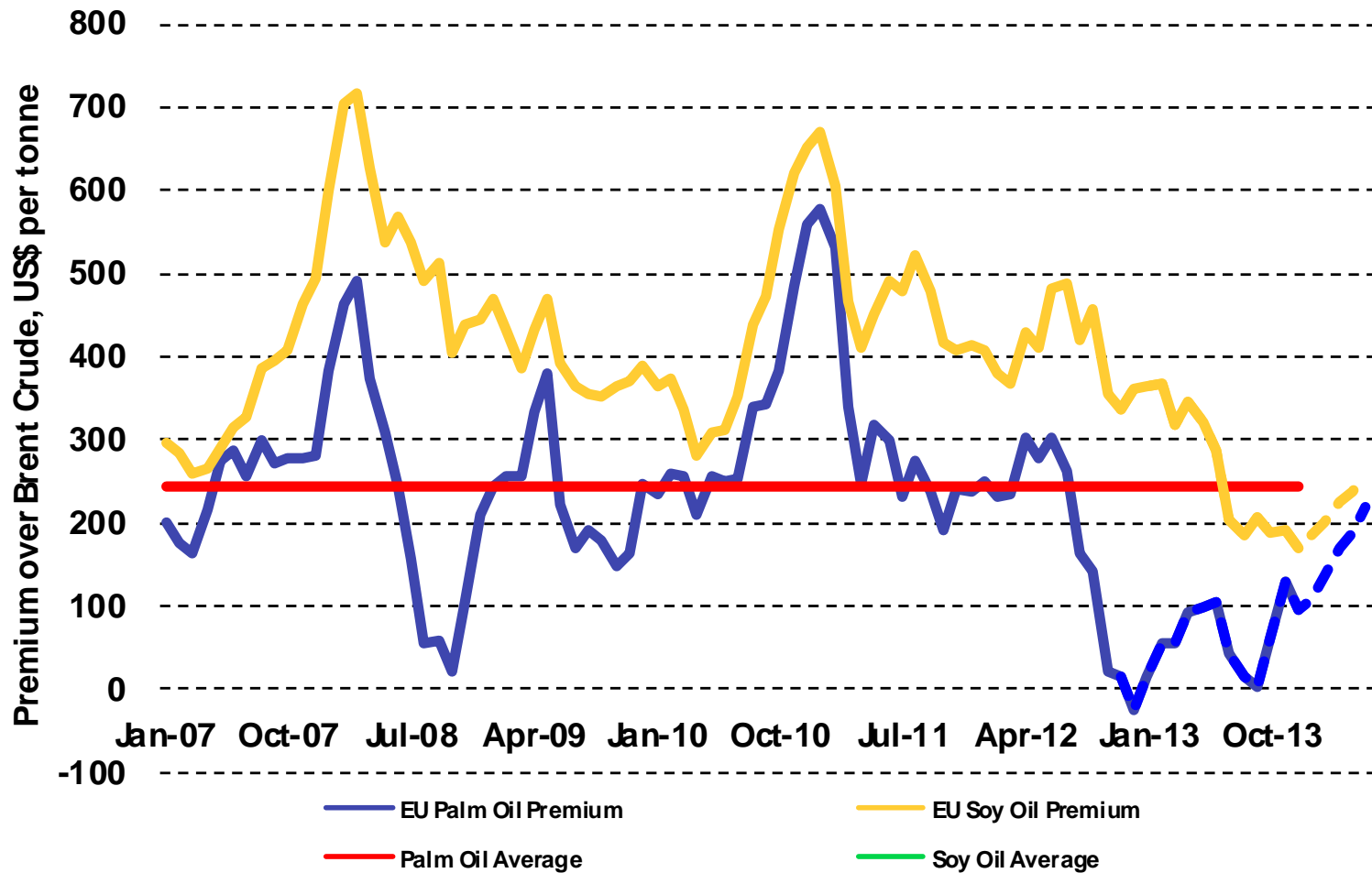
If that demand becomes less sure, then these supplies of seed oils will have to work harder than they have in the past few years in order to buy their way into new style, more price-sensitive fuel markets and thus follow the path pioneered by palm oil.



This is to remind you that today's rapeseed and soy oil premia are lower than they have been in the 7 years since the new "biofuel era" began.



Looking ahead, palm oil should strengthen as the Indonesian mandate tightens stocks. This will support seed oils, but at lower premiums.



# Thank You

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Acknowledgments:  
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