Supply, Demand and Price

Dr Julian Conway McGill
POTS Mumbai, 26th of June 2014
Overview

I will start with a reminder of how the advent of biodiesel has permanently altered the oilseeds complex by creating a link between vegetable oils and crude oil prices.

I hope to convince you that, despite the waning enthusiasm for biodiesel in the EU and shrinking mandates in the US, this relationship is as strong as ever.

In fact the slowing growth in EU biodiesel, combined with bumper harvests in the Black Sea, paradoxically means that crude oil has become more important for vegetable oil prices.

The foundation of the relationship is in SEA, where differential export taxes have made palm oil cheap as a fuel, outside of any government mandates.

The differential export taxes have had other unanticipated effects, and I conclude by looking at how they have changed refining margins.
Since 2007, a price band has appeared, linking vegetable oil prices to petroleum prices, with oils priced at a premium to Brent crude.
In 2000, less than 1% of the world’s oils went for biofuels. By 2007 it had reached 7% overall and close to 20% of rapeseed oil.
Since 2007, a price band has appeared, linking vegetable oil prices to petroleum prices, with oils priced at a premium to Brent crude.
We should focus our attention on the spreads between oils prices and Brent crude. EU CPO prices have (on a daily basis) fallen below crude, but the floor has held firm.
Support for biodiesel in the EU is waning. Lower EU biofuel targets and “double counting of waste oils” cut demand for vegetable oil methyl ester.
The US hit a 10% ethanol blend wall, making it impossible to meet projected biofuel mandates, shown here, which rely very heavily on ethanol. Congress may also not repeat it’s previous largess and give a $1/gallon blending credit.
While we have shown that the price band has held firm in the EU, what will happen in the future in the absence of government support for biodiesel and the blend-wall approaching?
The answer lies in South East Asia where FOB prices have spent longer at a discount.
In particular in Indonesia: because of the export tax system, CPO has been cheap as a fuel source – outside of any government incentives – for long periods.
A ‘crude’ method of forecasting vegetable oil prices

With the price band still intact, the first part to understanding the price of vegetable oils today is the petroleum (crude oil) price.

The second part is to understand the premium for individual vegetable oils over petroleum inside the price band.

The decline in EU biodiesel mandates and bumper crops in the Black Sea region mean this premium has shrunk recently.
The CPO premium over Brent usually moves in the opposite direction to MPOB stocks.
The seed oil spreads over Brent depend on their demand and supply. They have fallen recently causing a flattening of the price band.
The explanation for this lies in the bumper harvests in Ukraine and Russia, who have responded to the demand for sunflower oil from the EU since the advent of biodiesel policy.
At the same time, Indonesia’s export tax reforms, competition have hit their refining margins. FOB S.E. Asia and CIF EU margins are now negative.
धन्यवाद

www.lmc.co.uk
This presentation and its contents are to be held confidential by the client, and are not to be disclosed, in whole or in part, in any manner, to a third party without the prior written consent of LMC International.

While LMC has endeavoured to ensure the accuracy of the data, estimates and forecasts contained in this presentation, any decisions based on them (including those involving investment and planning) are at the client’s own risk.

LMC International can accept no liability regarding information analysis and forecasts contained in this presentation.