Demystifying Palm Oil in the Era of VUCA & Its Impact on India

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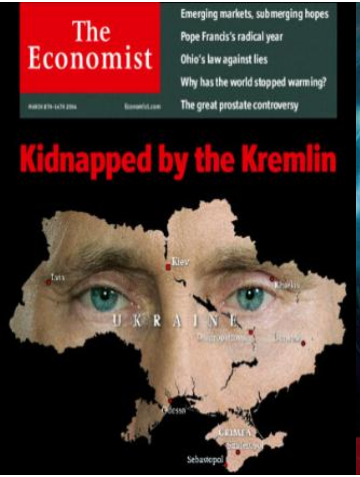
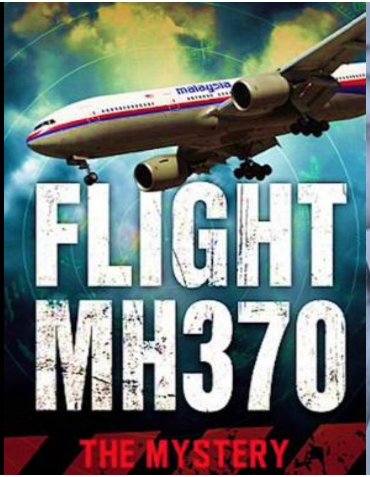
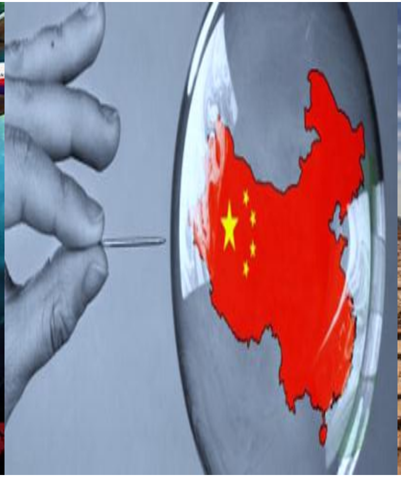
VUCA

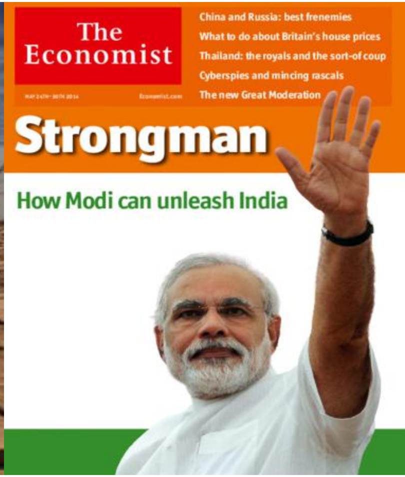
Term coined by US Army War College & better explained by Taleb's Black Swan

VUCA stands for the volatility, uncertainty, complexity, and ambiguity—reflecting an unstable and rapidly changing economic environment. Better explained by concept of Black Swan (ie) combination of low predictable events with large impacts







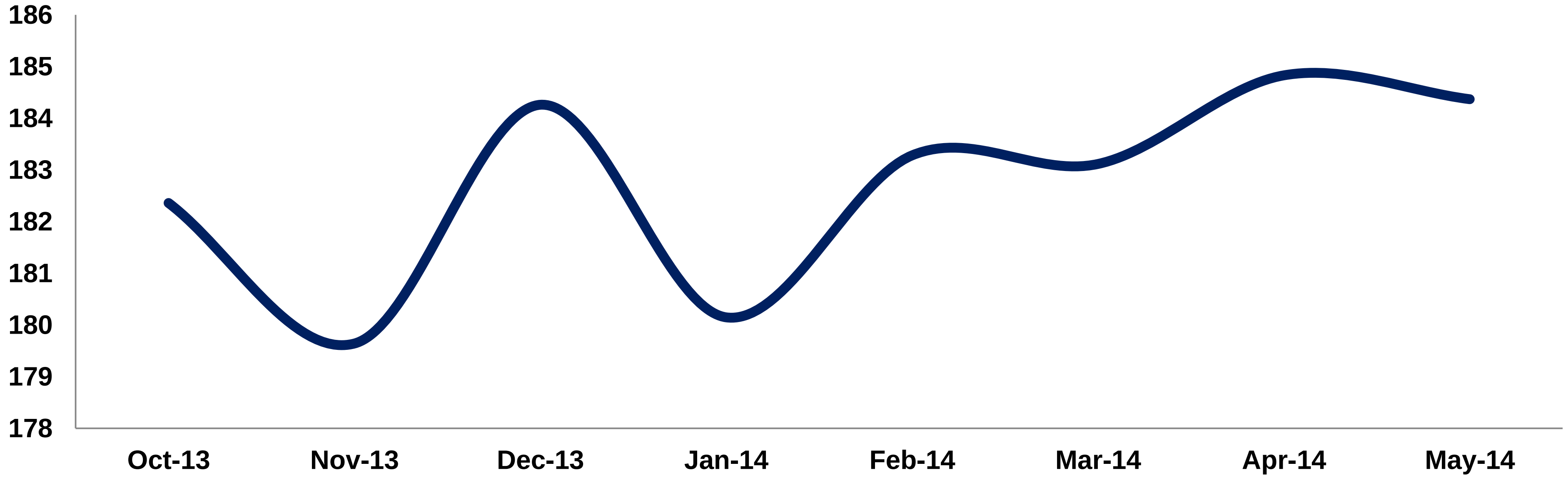


First Half of 2014 has witnessed several such events from on going turbulence in Middle Eastern Countries to Russia invading Ukraine to Missing Malaysian Flight to Ferry Mishap in South Korea to Chinese Shadow Banking to Searching for El Nino to Change in leadership in World Largest Democracy (India), etc. All of the events has taken world by surprise

There are two kinds of rare events : one which will all talk about & other which no one knows about and is only discussed after its occurance. All of this events leads to VOLATILITY across asset classes, which is considered to be good for price discovery and it also helps traders to keep their job

IMF Commodity Price Index (Q3 2013 to May 2014)

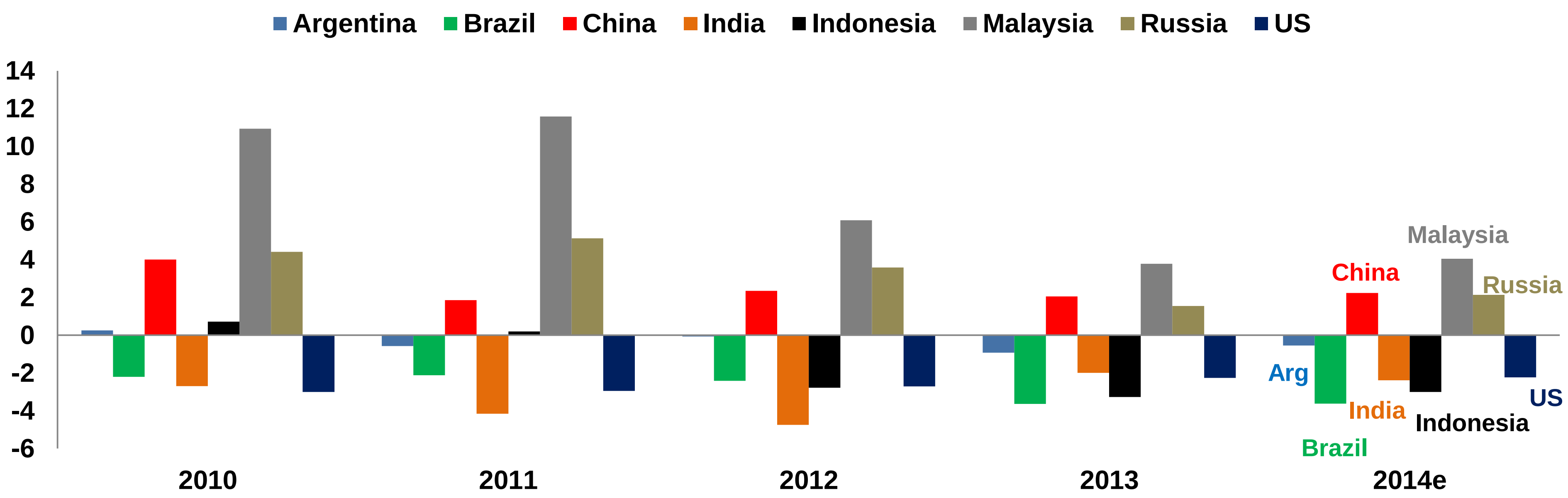
(Source : IMF)



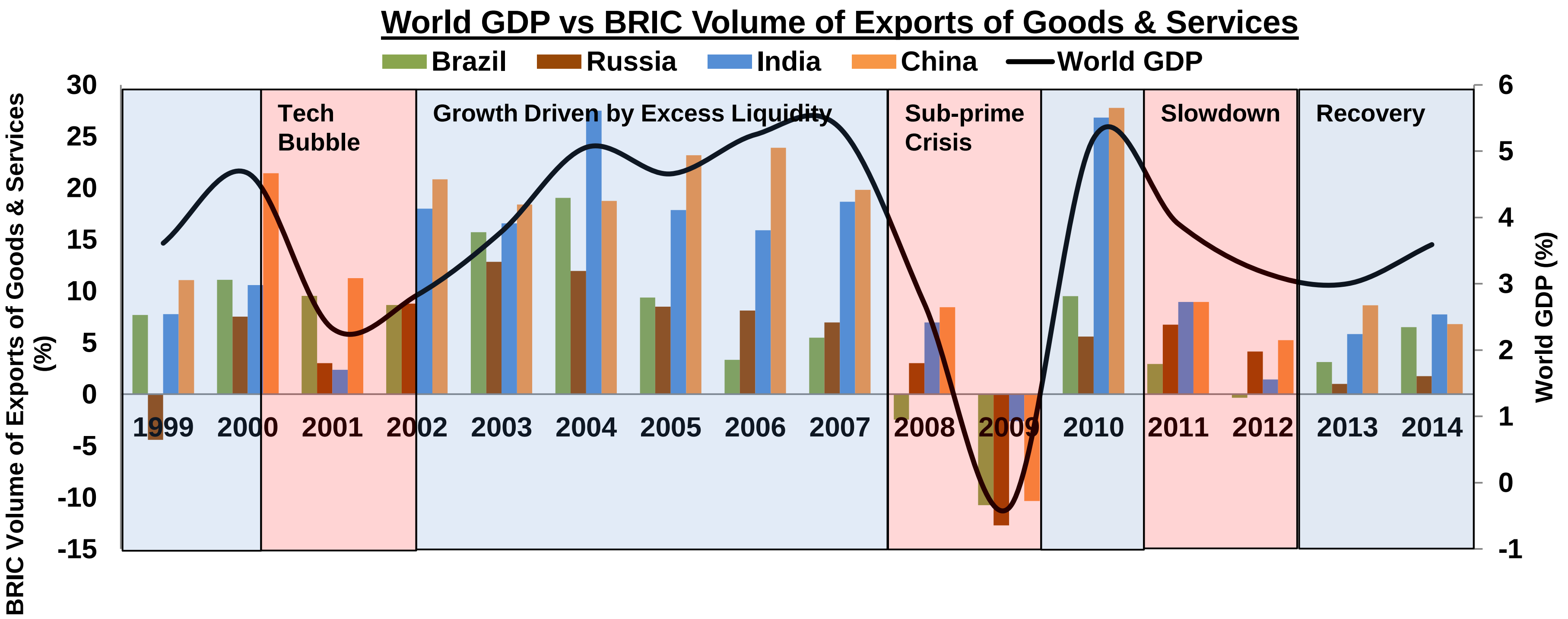
But Volatile prices has dire consequences for government's capacity to maintain current account balances stable, to finance domestic and external debt, and to provide social spending's. In turn it can derail countries economic growth

Current Account Balance % of GDP

(Source : IMF,WB&OECD)

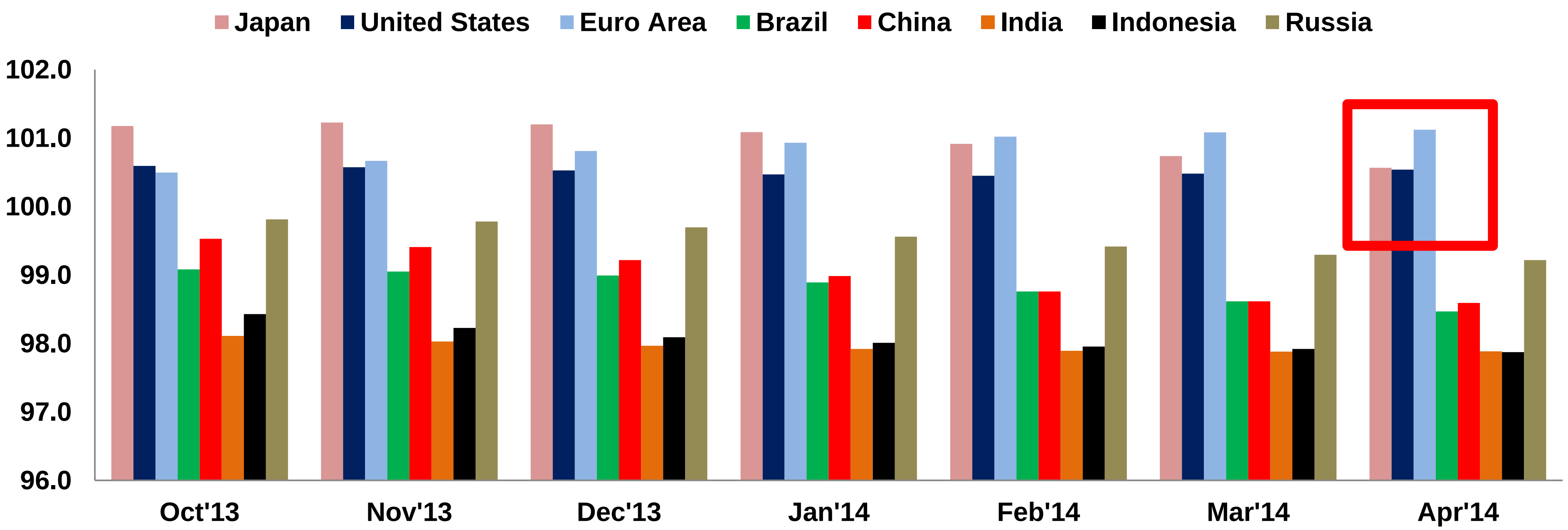


Global Economic Power shift has been taking place on account of wrong model being opted by Emerging Economies which was export driven (ie) dependent on Developed Economies Consumption Model instead of driven by its domestic demand & which continues to be the case…



It can be rightly said that Volatility is outcome of UNCERTAININTY which is now considered to be New Normal (by Bill Gross). In turn it has lead to global economic power shift back to Developed Economies from Emerging Economies post financial crisis

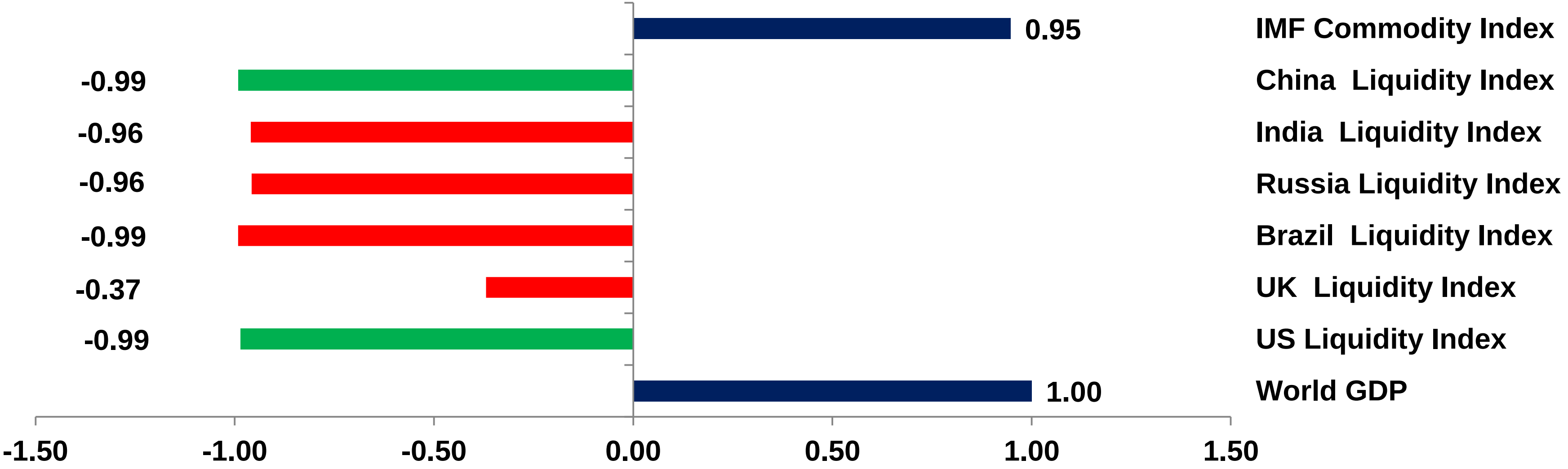
OECD Composite Leading Indicator Index (Oct'13 to Apr'14)



With growing uncertainty in turn has lead to COMPLEXITY, wherein the fundamentals holds little or no significance and it's the G2 & not the G20 which has been the major influencing factor in dictating terms for global growth

Global Growth & Commodity Index v/s Liquidity Index

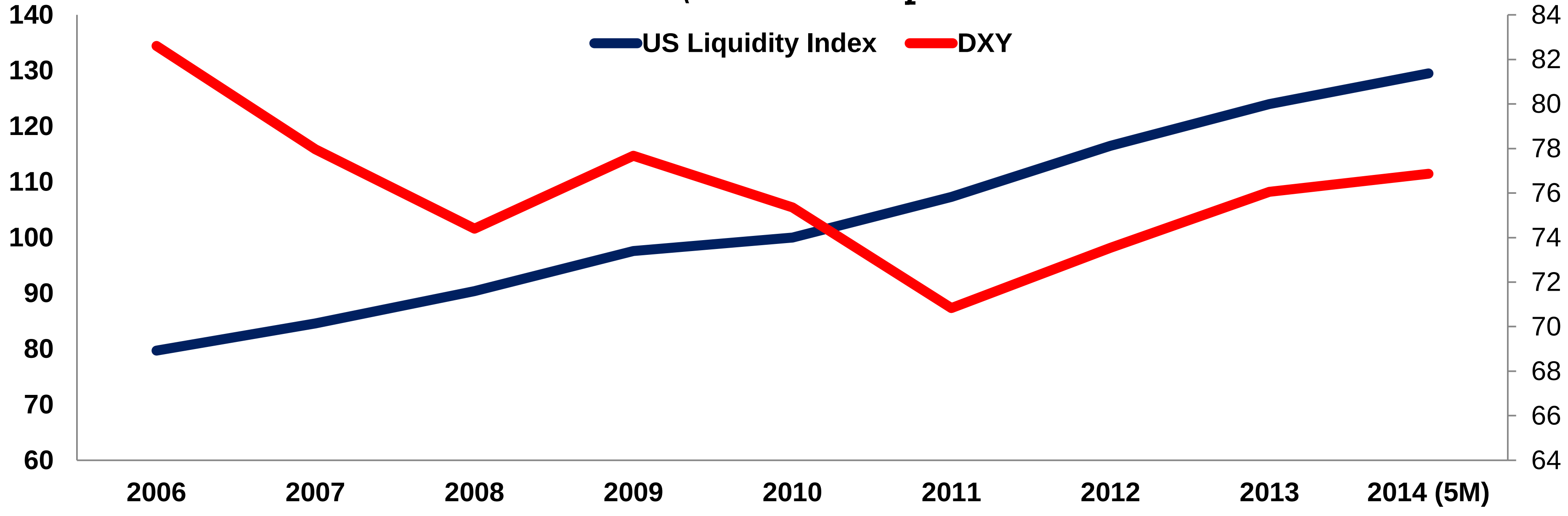
(Source : OECD & IMF)



It has got in its wake easy and heavily indebted credits which got multiplied by unsound financial and monetary policies. Process can be classified as "Capital is not a thing but a process in which money is perpetually sent in search of more money" in turn weakening sustainable growth

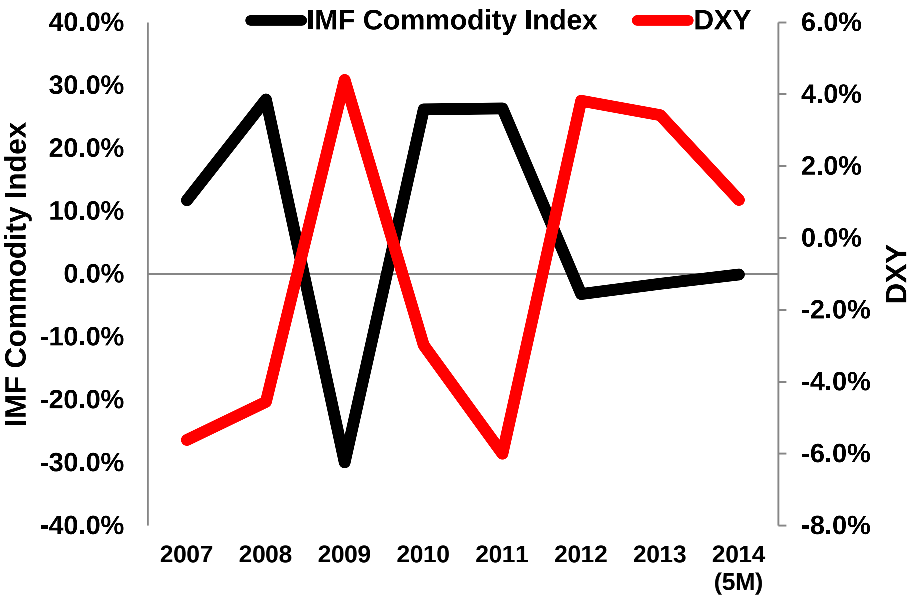
US Liquidity Index vs Dollar Index

(Source : IMF & Fed)

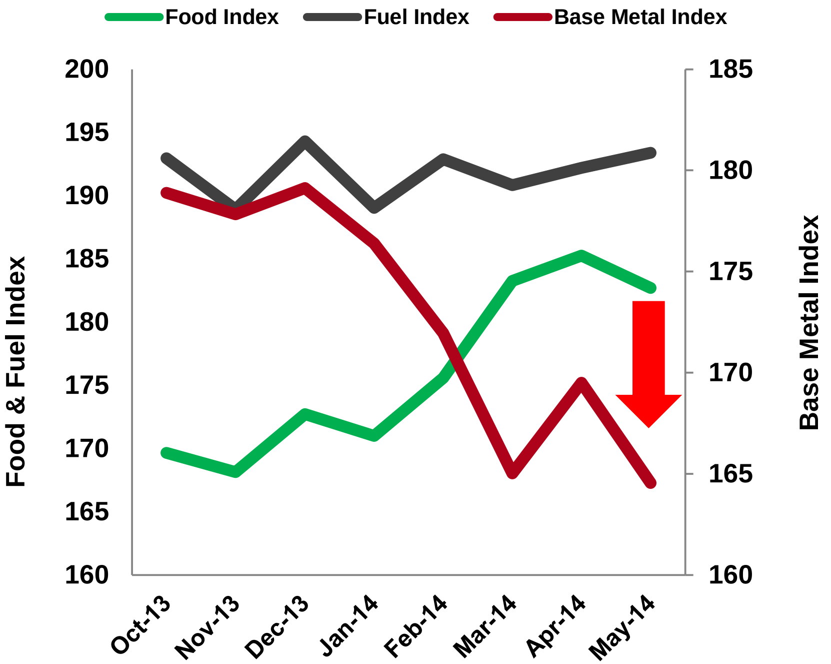


Beginning of the current year, due to unforeseen events mentioned earlier it has pushed up commodity prices especially energy & agro basket. But it was negative for base metals on account of Chinese credit concern and potential unwinding of Chinese Commodity Financing Deals

Trend Change in Dollar Index vs IMF Commodity Index ***(Source : IMF, Fed)***



IMF Commodity Indexes ***(Source : IMF)***

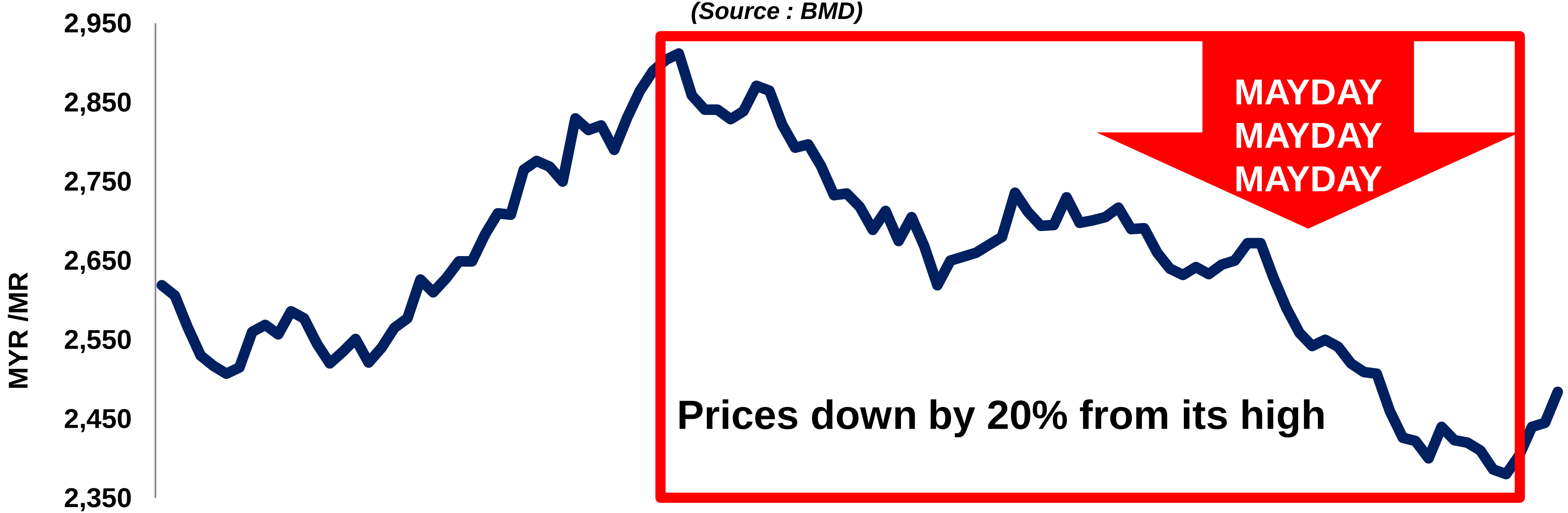


VUCA Impact on Palm Oil

CPO prices started CY 2014 on a positive note as it made a high of 2916 MYR during Mar 2014 (which was post POC 2014) on the back of dryness at producing centre, petroleum prices, Russia-Ukraine issue but post which there has continuous sell-off as it made a low of 2362 MYR during mid June…

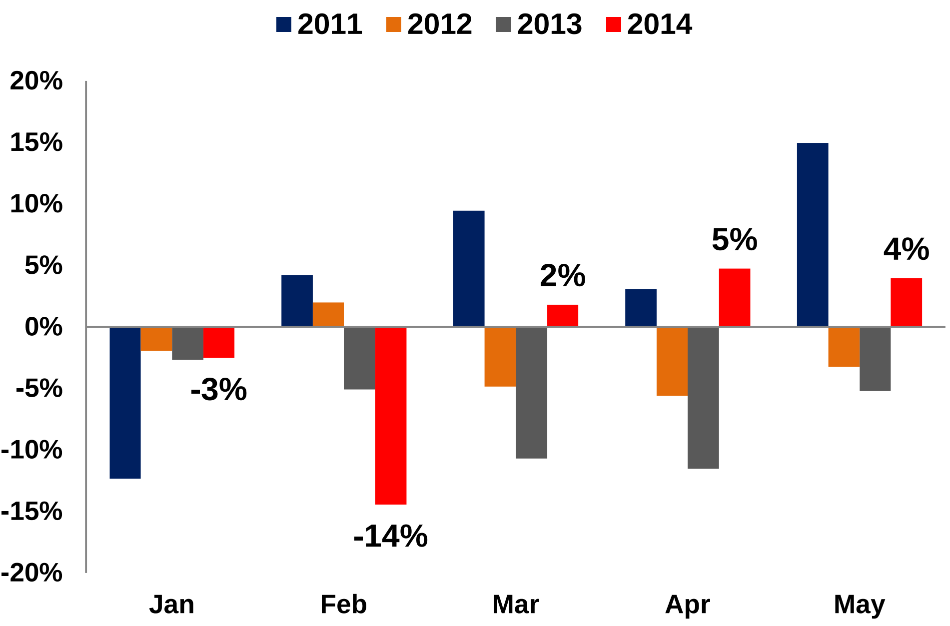
BMD CPO Prices (Jan 2014-Mid June 2014)

(Source : BMD)

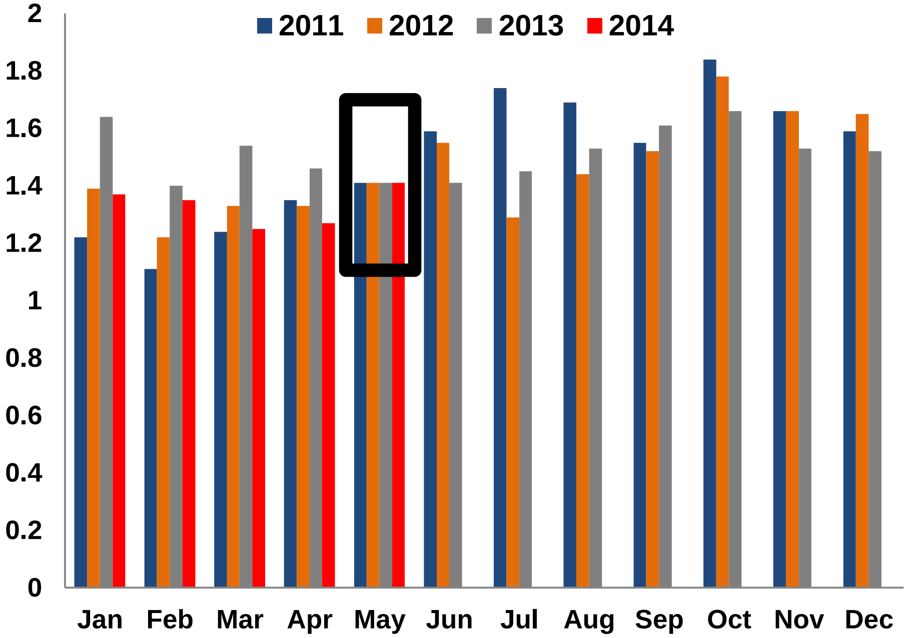


Sell-off was on the back of revival of rains at the producing centres, futile search for EL Nino, good supply of seed oil, currency fluctuation & steady petroleum price. Along with revival production numbers, feeble demand and stock build-up at producing centres

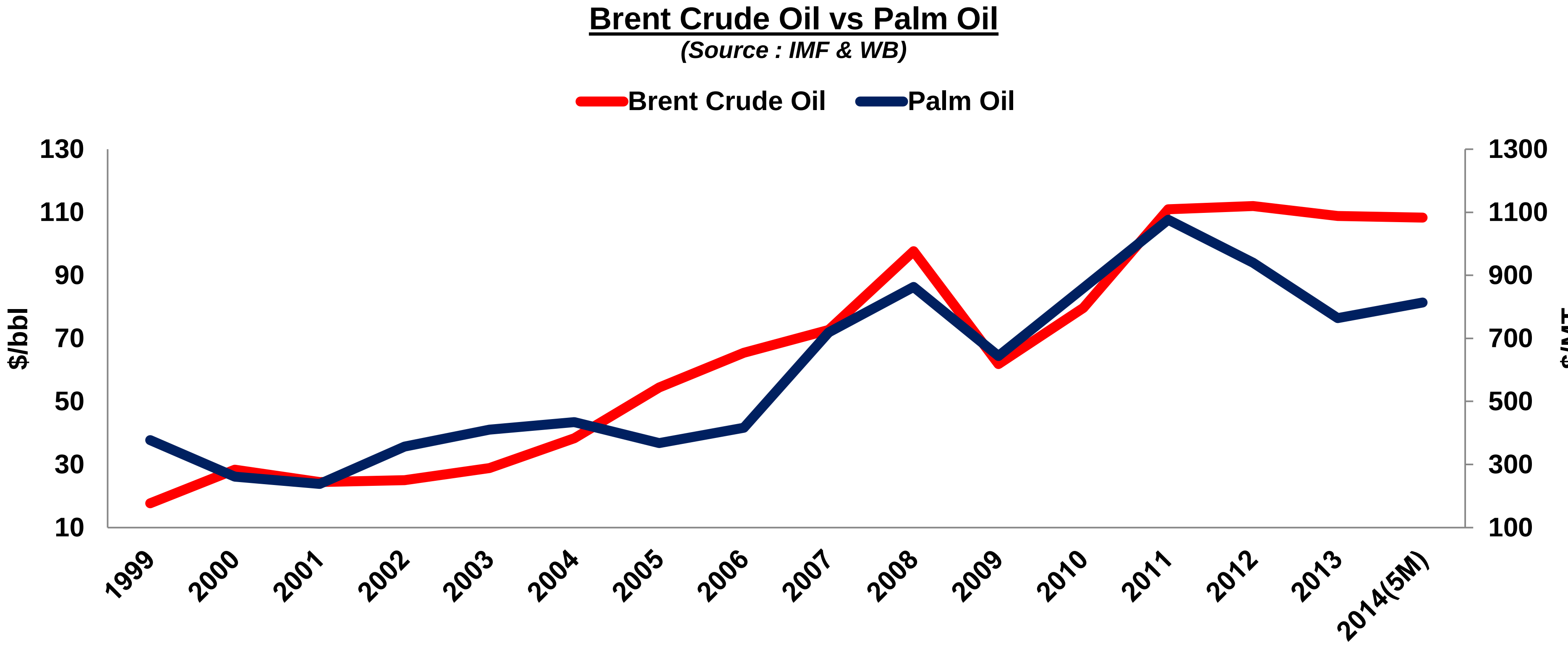
Malaysian Palm Oil Stocks Trend (M-o-M)
(Source :MPOB)



Malaysian Palm Oil Exports (MMT)
(May Constant Demand for 4yrs)

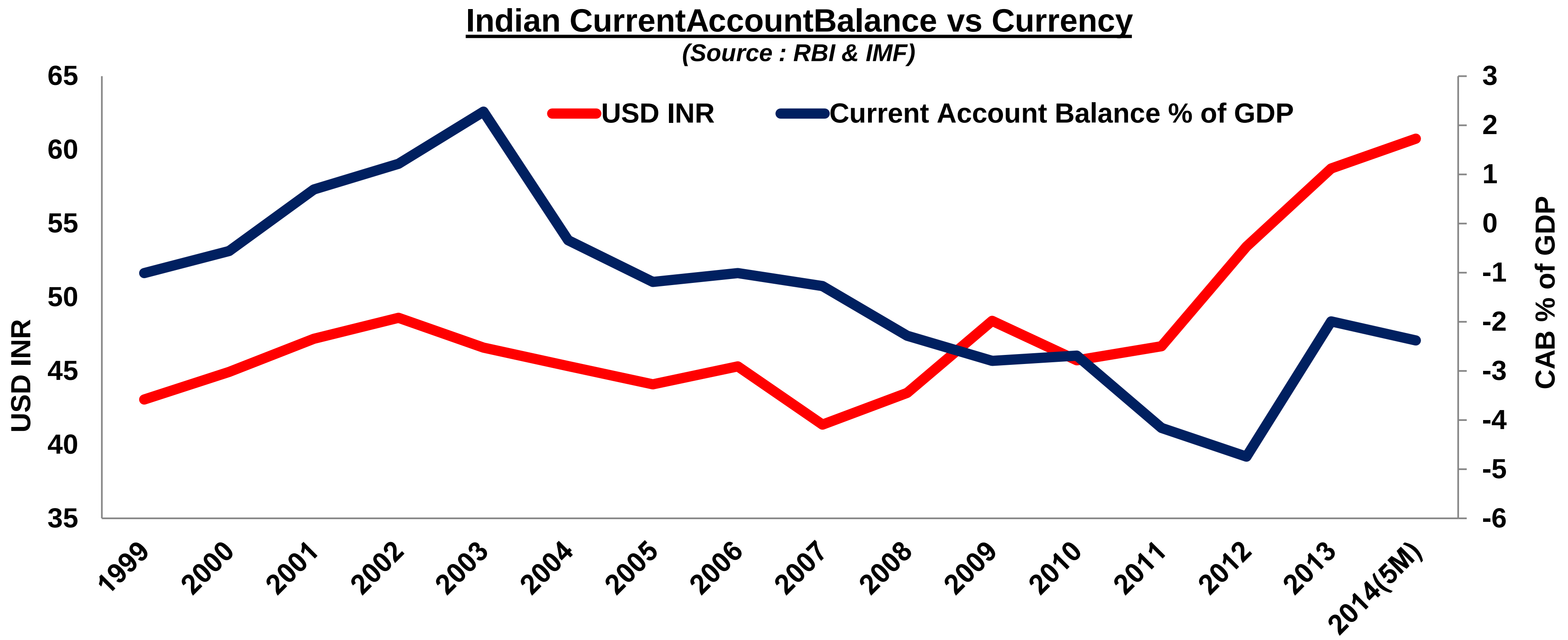


Even if fundamentals continues to remain weak but Palm Oil always tends to find saviour in the form of petroleum prices. Reason being supportive for USD MYR as Malaysia in net exporting nation along with demand rationing towards BioD, STRONG POSITIVE CORRELATION between Brent &CPO

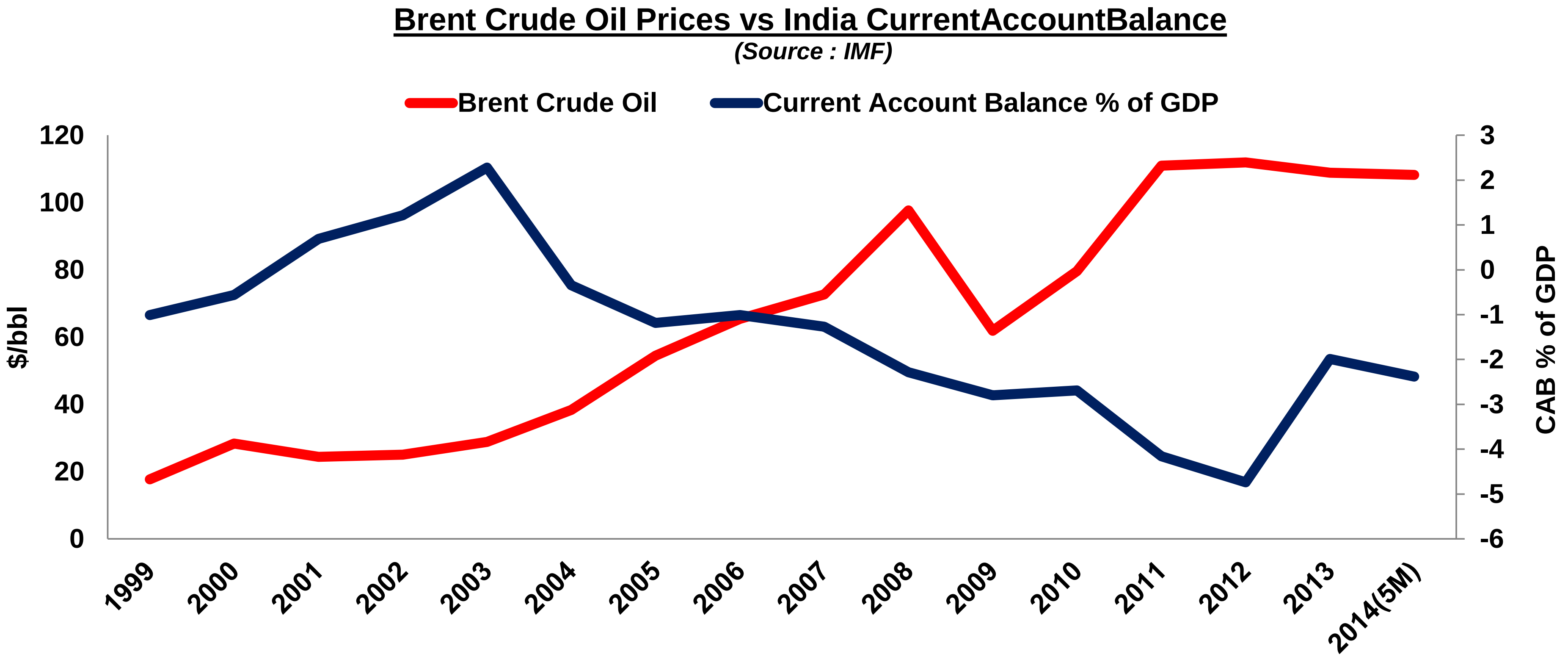


VUCA Impact on India

India is more vulnerable to VUCA impact as Govt continues to struggle with its Current Account Deficit (CAD) in turn weakening USD INR leading to higher import bills in case of "Oils" – Edible as well as Petroleum in turn leading to inflationary pressure & slowing down of growth engine

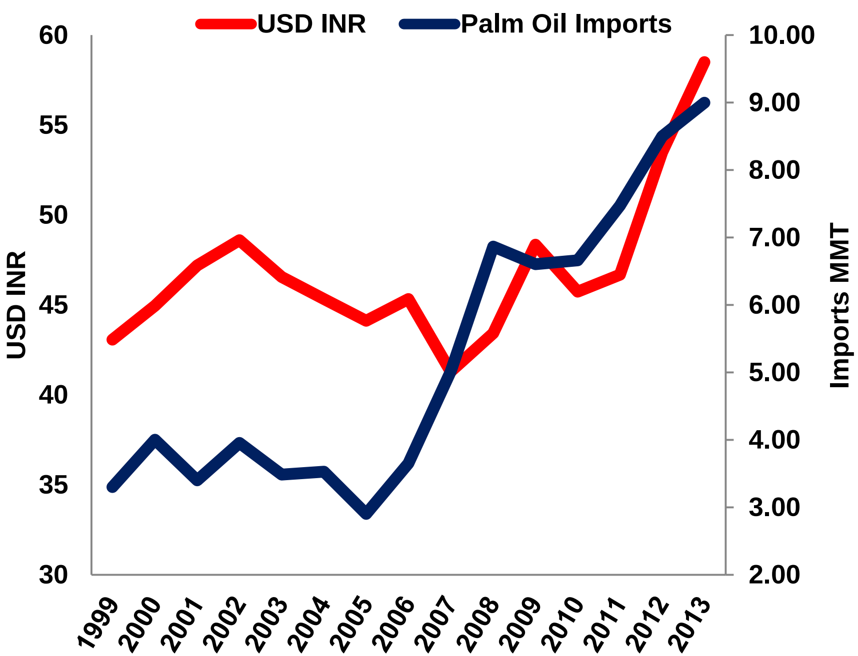


CAD has a strong negative correlation with petroleum prices as India is net importing nation of petroleum & its products. It accounts almost 40% of nation's import bill which leads to depreciating INR reason being good outflow of dollars

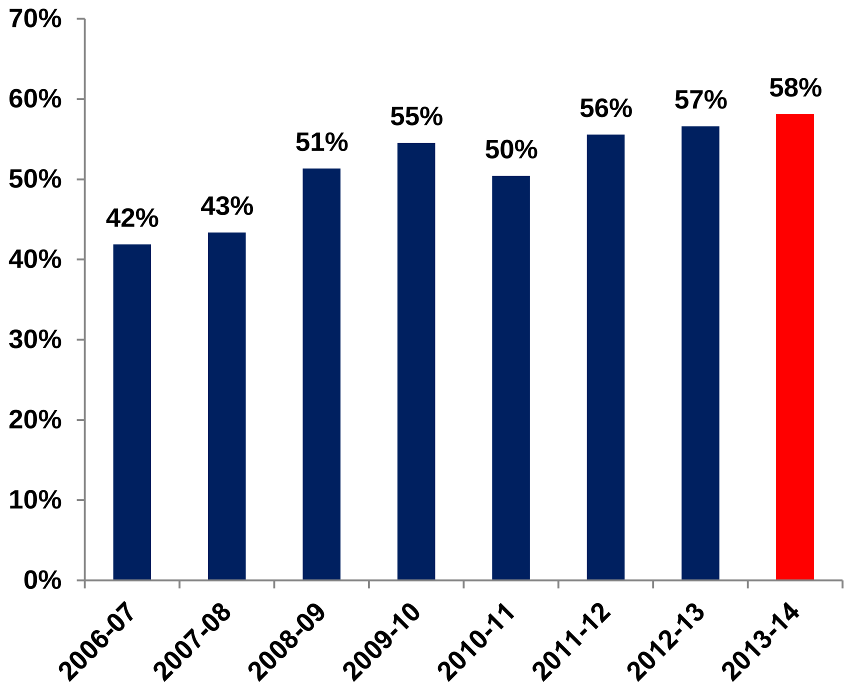


As we have seen before there is strong positive correlation between petroleum prices & palm oil prices. India is vulnerable to surge in prices of both the commodities, as it cannot produce the same domestically and has high percentage of household income spend in foods (ie) 35%

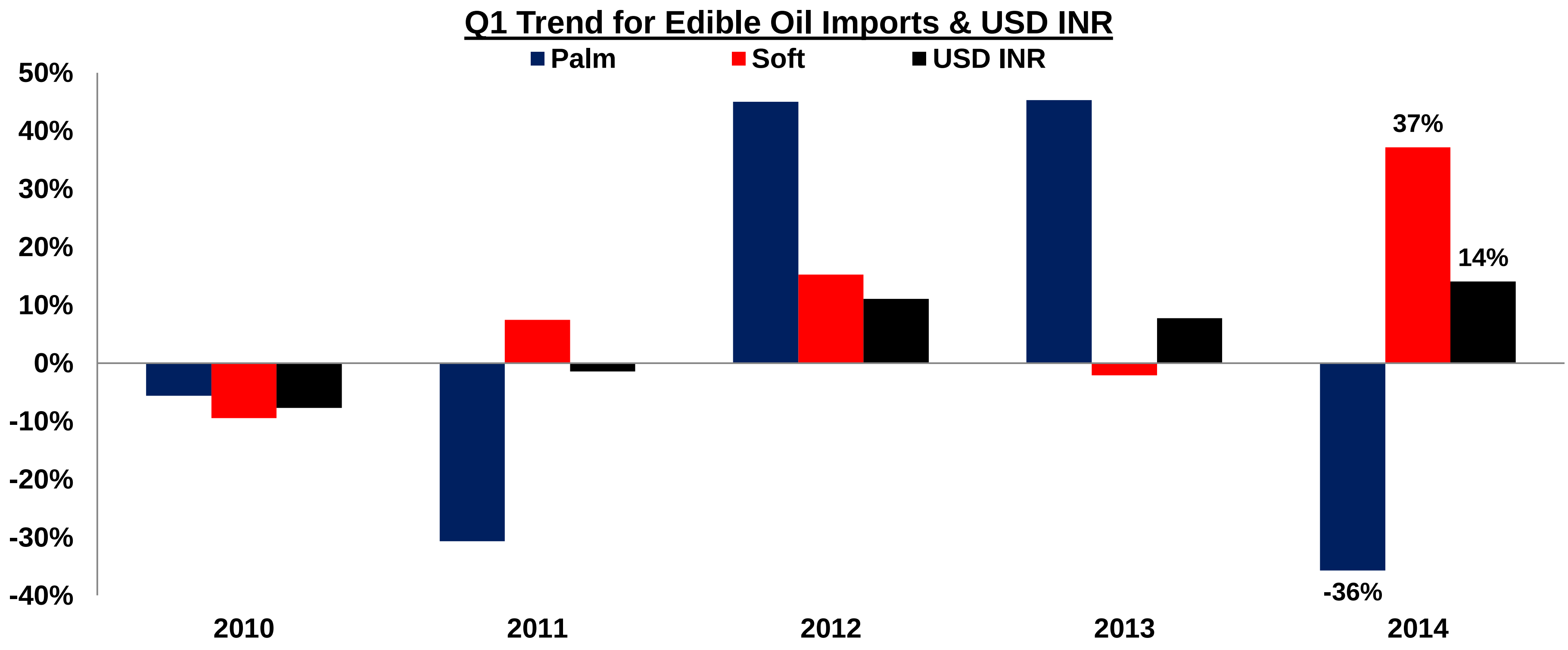
India Palm Oil Imports vs USD INR



India Edible Oil Import Depenedency (%)



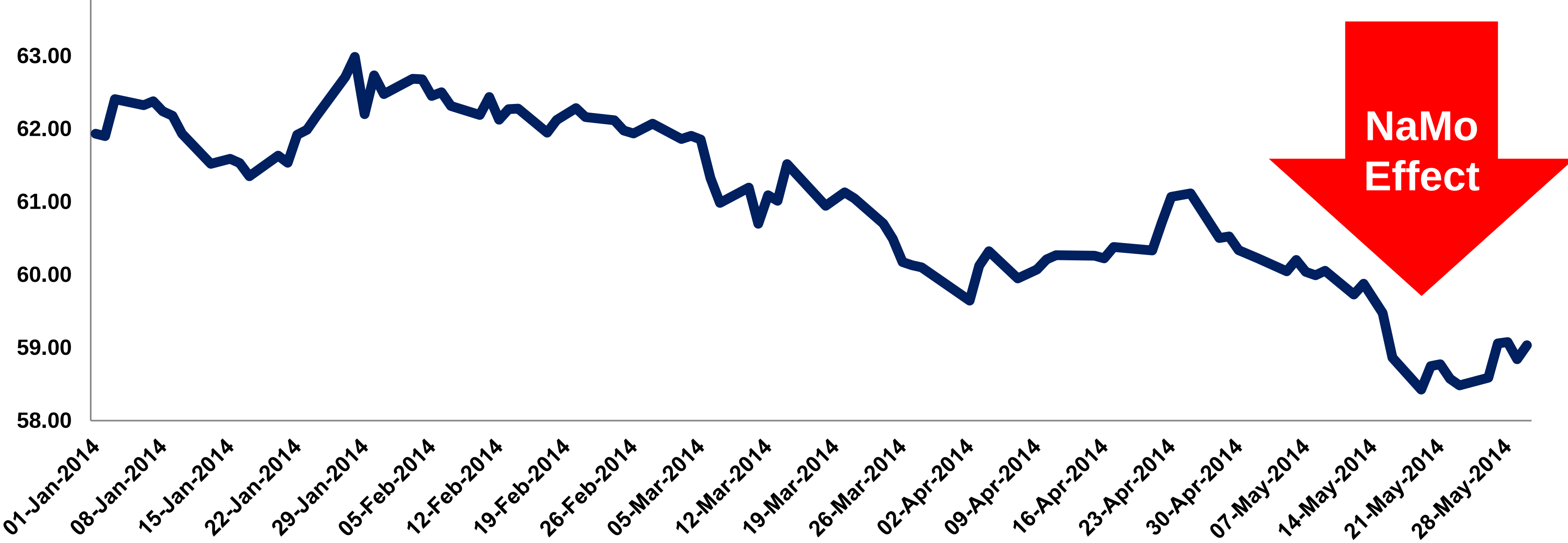
However, if we were to analyse the trend of edible oil imports for Q1 of current calendar year. Wherein the pace of palm oil imports has slumped as there has been significant demand shift towards soft oils (sun&soy), substitution effect due to price. USD INR remained elevated during the period



From RaGa to NaMo : Post Q1 of 2014, Rupee showed a good recovery on account of leadership change in World Largest Democracy (26th May) which took world by surprised as outright majority win for single party in the Lok Sabha election – the last time was in 1984

USD INR (Apr-May 2014)

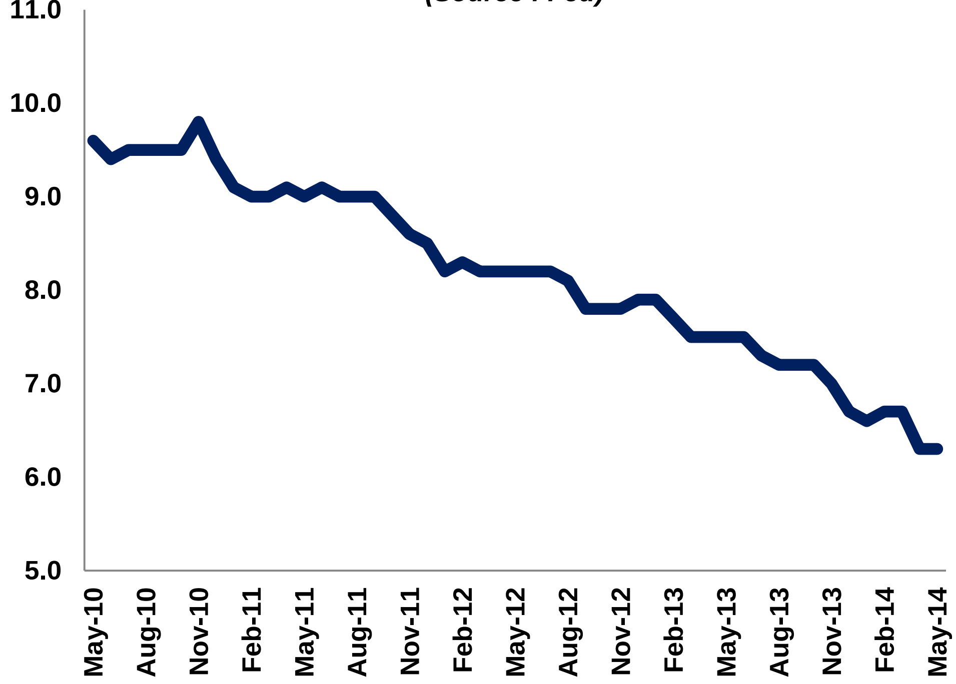
(Source : RBI)



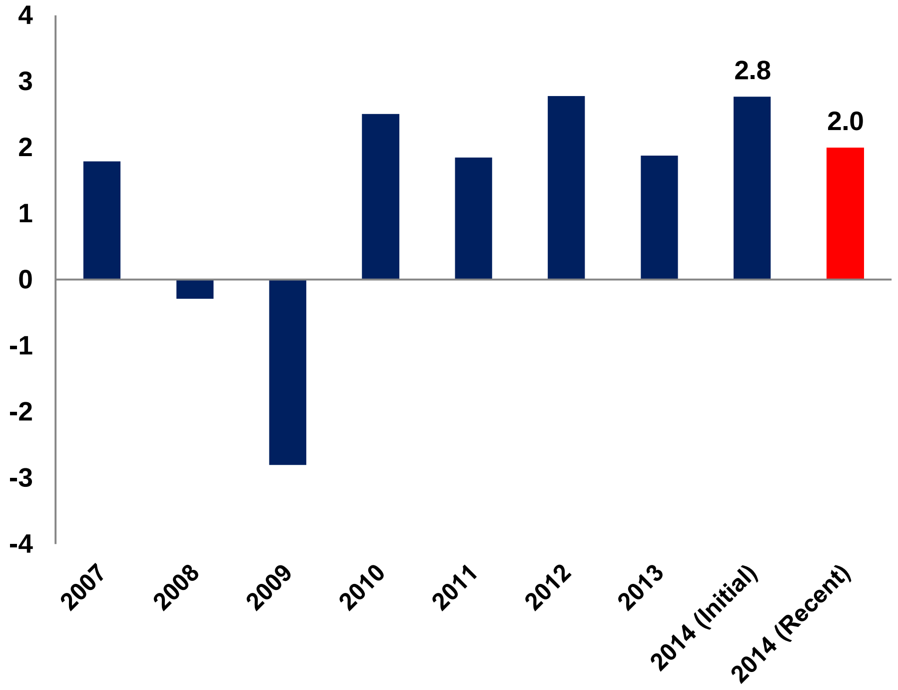
Outlook Under Influence of VUCA

Global Economy will continue to remain under VUCA influence as there is no escape out. Possibility of it getting intensified in turn could derail the global growth, as US is struggling with its growth due to weather abnormalities in Q1 following which IMF has downgraded its growth prospects from 2.8to2%

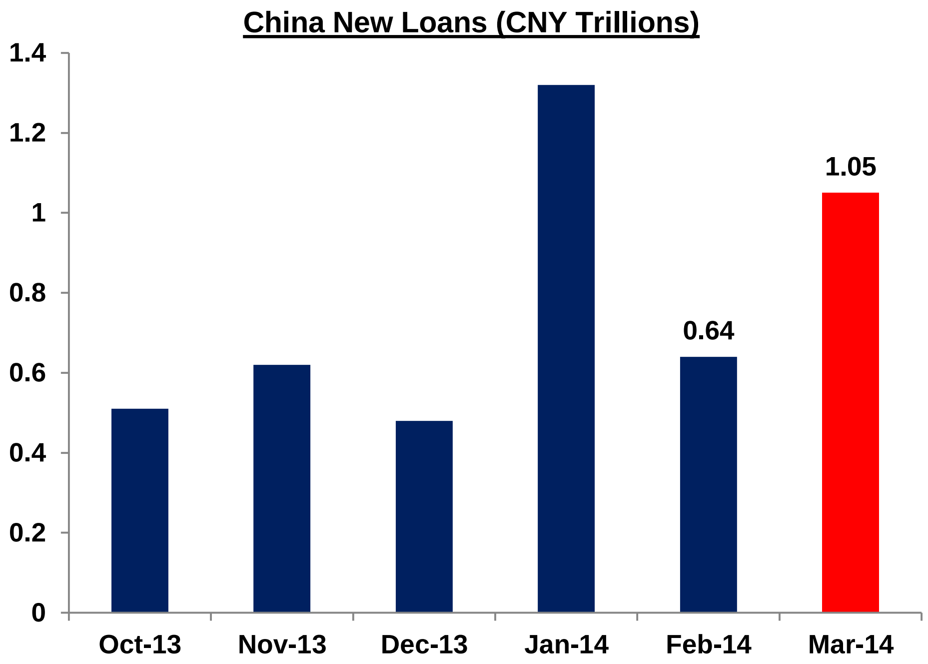
US Unemployment Rate
(Source : Fed)



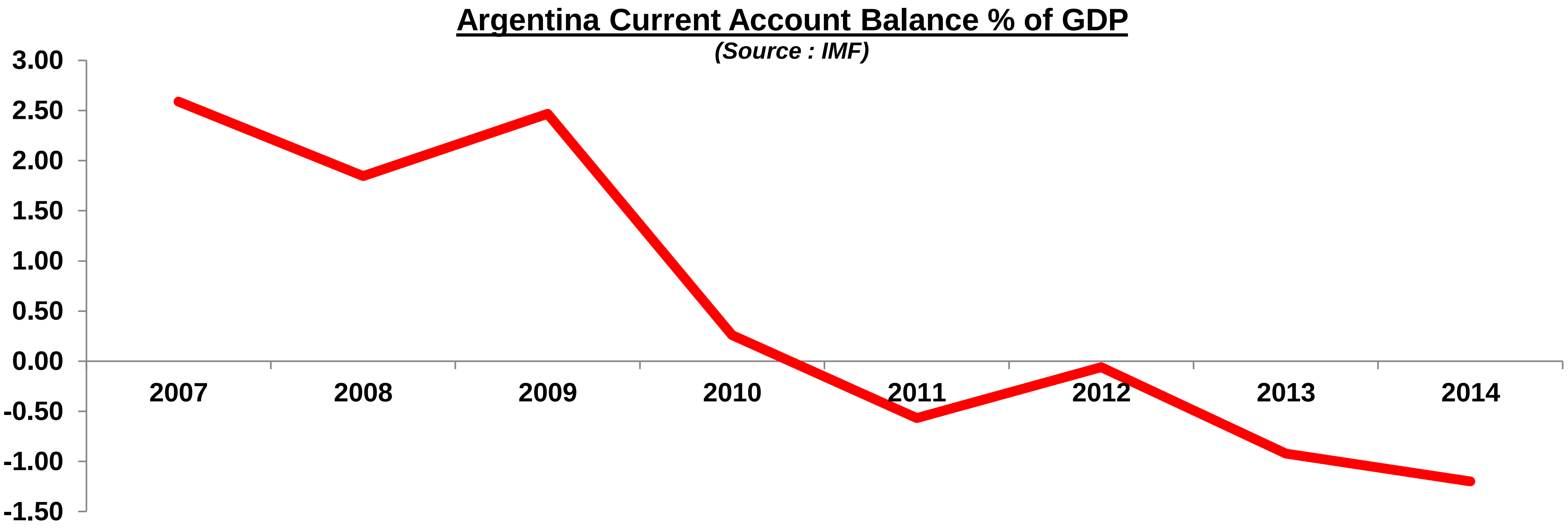
US GDP Growth (%)
(Source : Fed & IMF)



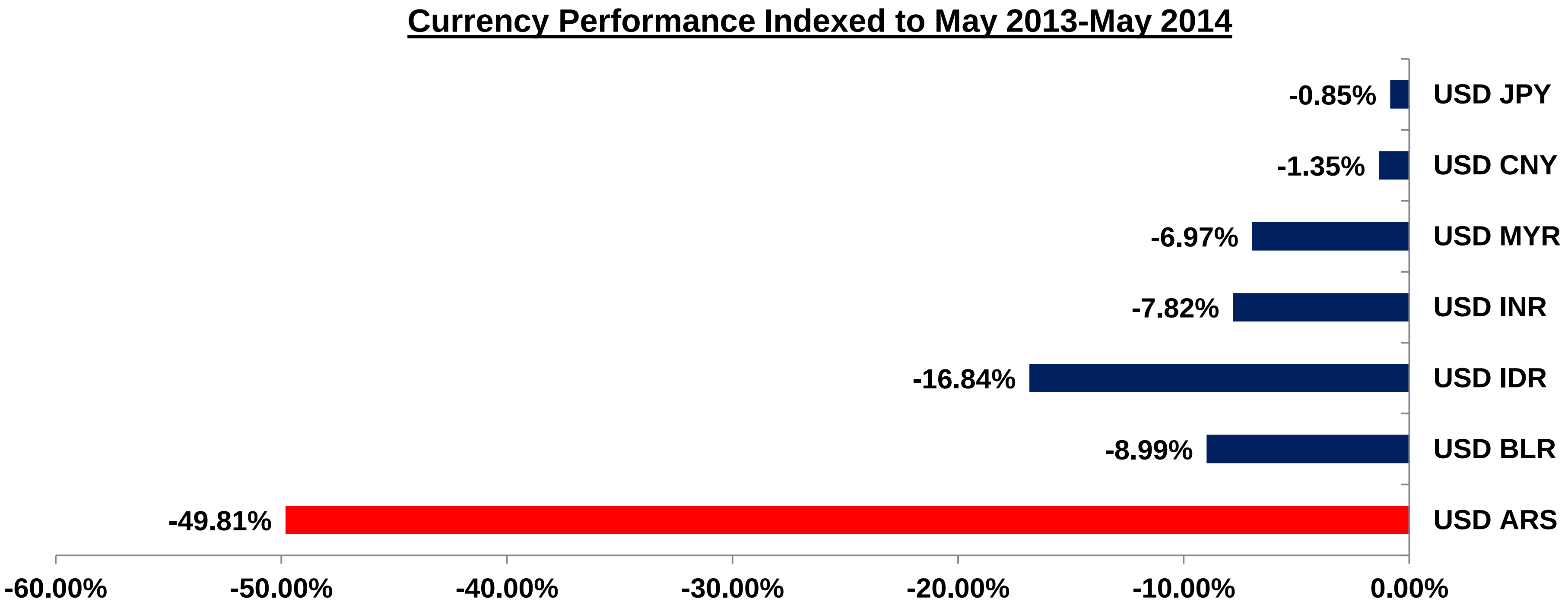
China continues to struggle with it growth as countries financing sector is getting out of its "Shadow". However, to keep the wheel churning there has been huge influx of liquidity in the system which is heading towards housing sector(NO-MONEY-DOWN-LOANS). Possible BLACK SWAN



Will Argentina default on its debt??? As argument gets in favour of "PARI PASSU" clause. Bond payment due by 30th June. Only way payout is possible by printing money in turn would lead to higher inflation & Argentine economy getting in Stagflation. Can it lead to good harvest LIQUIDATION???



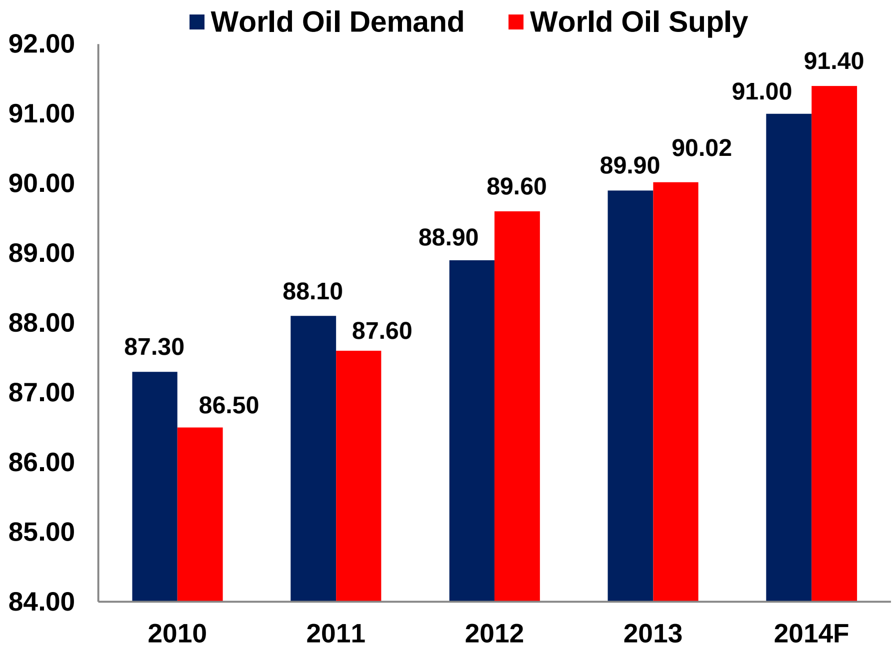
Hence, with muted recovery in the US and the tapering of the Fed, as well as expectations of continued monetary stimulus from the ECB, continued efforts to weaken the yen by the BoJ and the weakness of emerging markets, the US dollar is expected to appreciate in the coming months



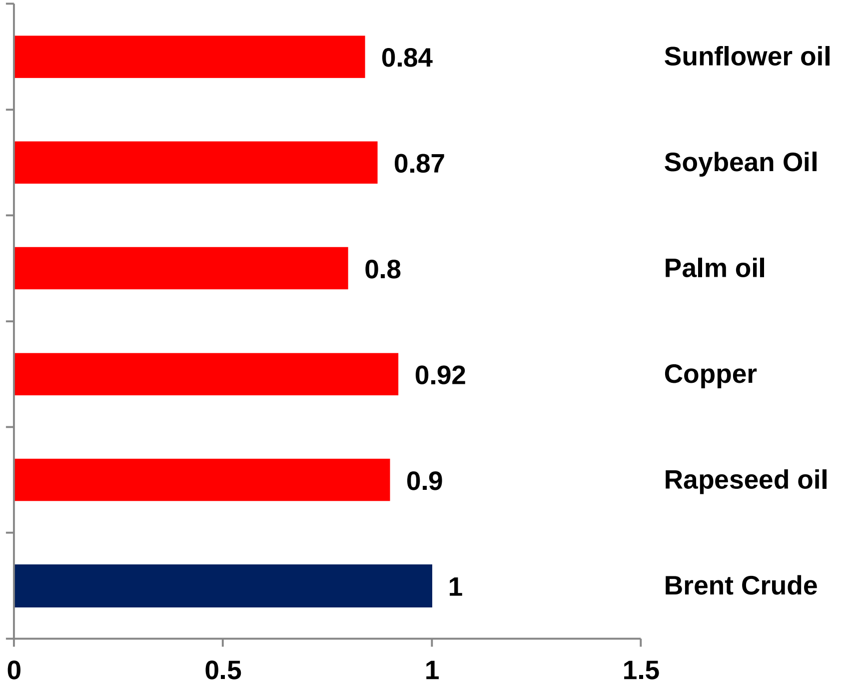
With Dollar expected to strengthen which will have reverse impact on commodities. Crude oil fundamentals (supply –demand) seems to be fairly balanced. However, major concern being GeoPoli intensifying in Middle East. Would lead to supply disruption & can derail global growth

World Demand & Supply of Petroleum (MB/D)

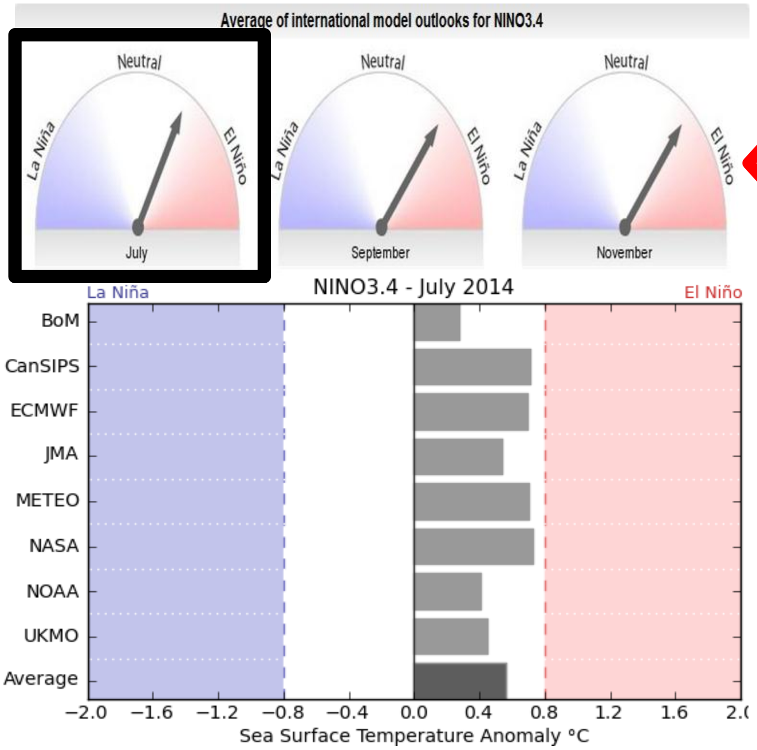
(Source : OPEC)

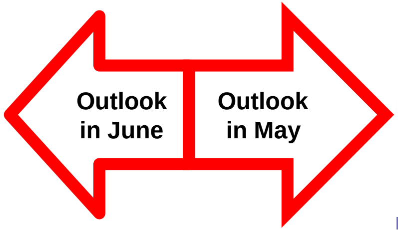


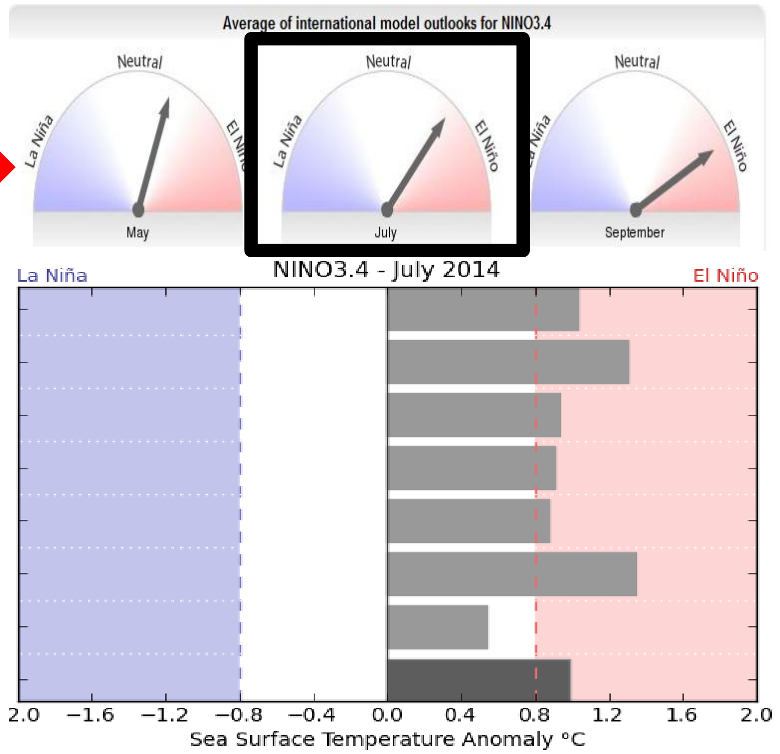
Brent Crude vs Edible Oil : Correlation Graph



Search operation for EL Nino which started since start of CY is still on. During the June update by ABOM wherein El Nino intensity will be witnessed between Aug-Sep whereas the same agency had forecasted in May that impact to be witnessed by July. But to no avail only abnormalities





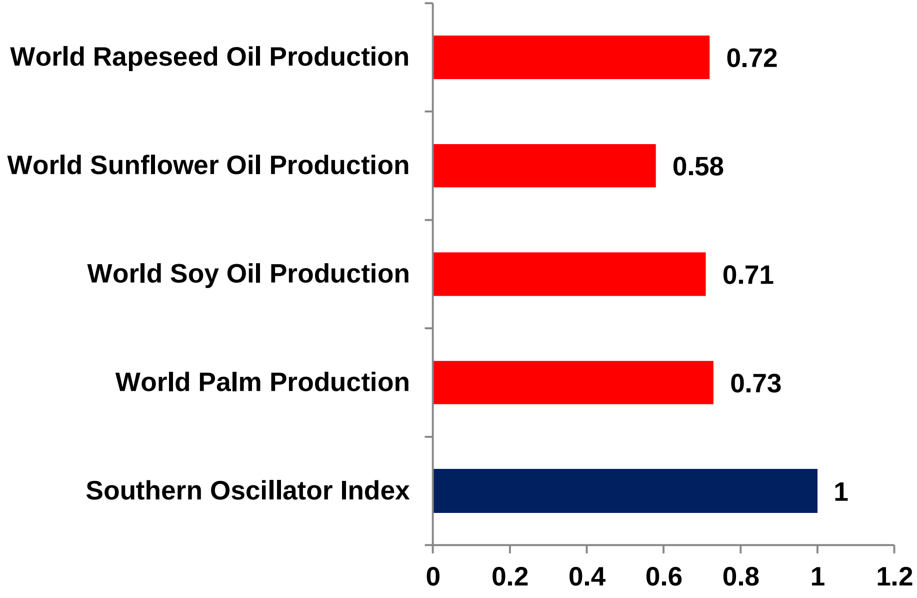


In case EL Nino warning turns out to be true its impact on Palm Oil production will be only witnessed during start of 2015. However, weather will be favourable for Soybean (LatAM & US). Monsoon dependent Indian Kharif Crop will get impacted & can result in higher inflation in turn weak USD INR

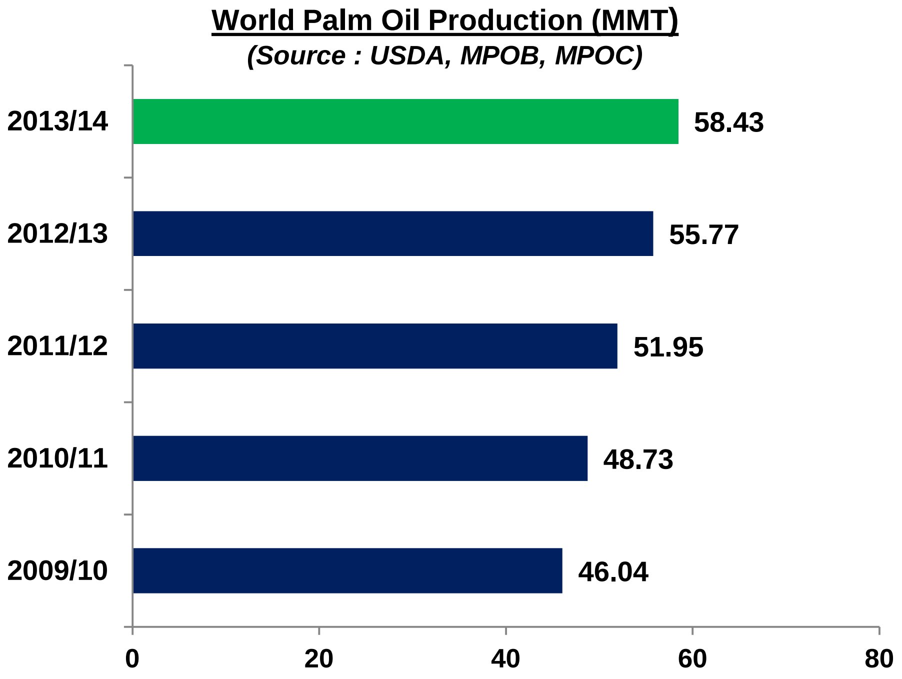
Weather Impact Metrics Postulated on Palm Oil

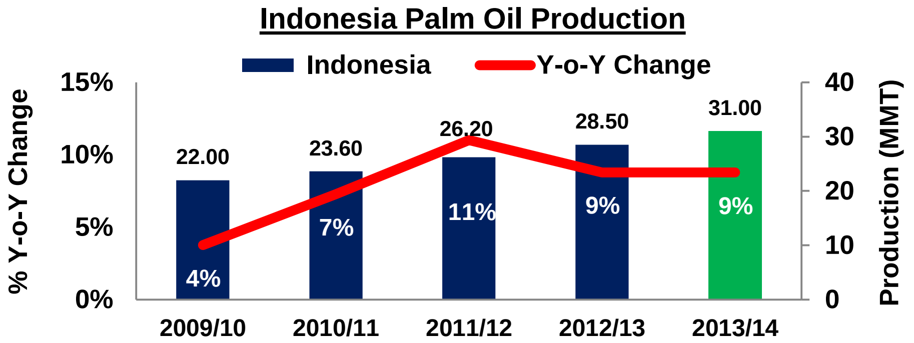
	Southern Oscillator Index (SOI)	World Palm Oil Production (POP)	World Palm Oil Exports (POE)	World Palm Industry Use (PIU)	World Palm Food Use (PFU)	Palm Oil Prices (POP)
SOI	**1**					
POP	**0.70**	**1**				
POE	**0.73**	**0.99**	**1**			
PIU	**0.69**	**0.99**	**0.99**	**1**		
PFU	**0.81**	**0.99**	**0.99**	**0.99**	**1**	
POP	**0.85**	**0.80**	**0.80**	**0.81**	**0.81**	**1**

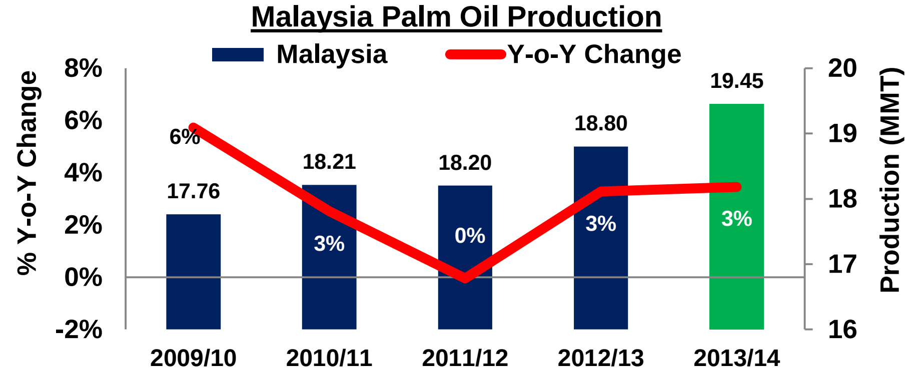
Southern Oscillator Index vs Edible Oil : Correlation Graph



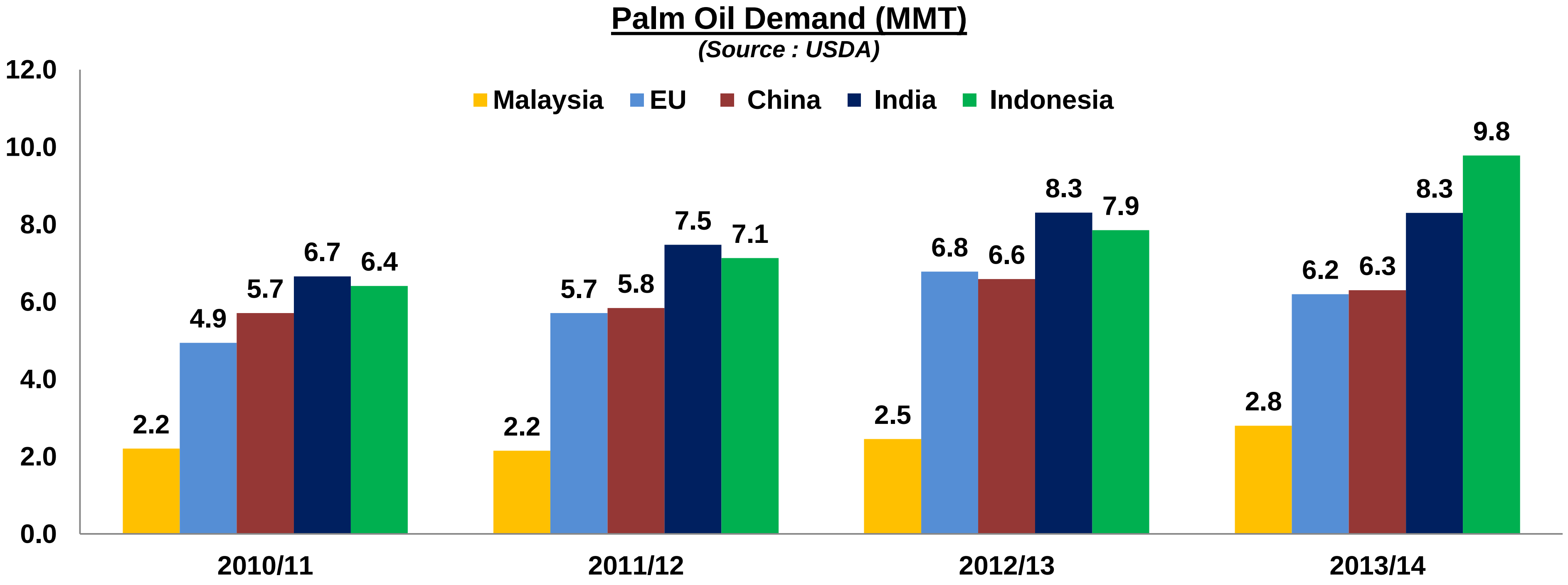
Palm oil production in both Indonesia & Malaysia after dry spell during the start of CY has recovered sharply & expected to maintain momentum. There can be harvest slowdown between July & early August on account of labour leave. OVERALL WEATHER RISK LOOMS which can only alter output





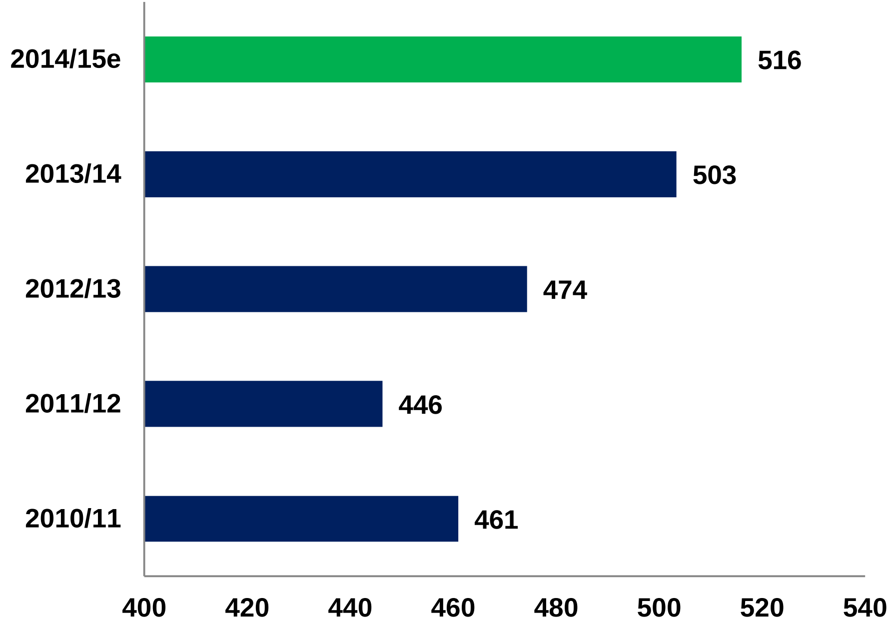


On the consumption front major importing destination will remain more or less at same levels as last couple of years. But it will be producing centres which is expected to report increase in demand, as they unveil their TRUMP CARD of BioD which will act as a minimum support price (MSP) for CPO

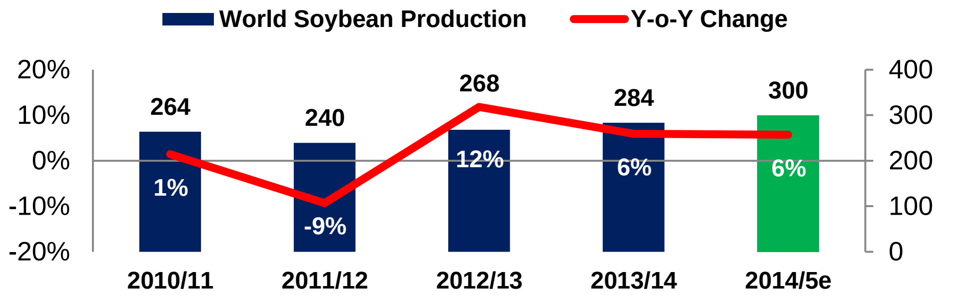


However, Oil Year will be dominated by oilseeds complex. Leading its way will be soybean followed by rapeseed & sunseed crop. Reason being good LatAm crop from Argentina (53-54mmt) & Brazil (89-90mmt). Even if there are any weather glitches world will have enough seed to extract oil

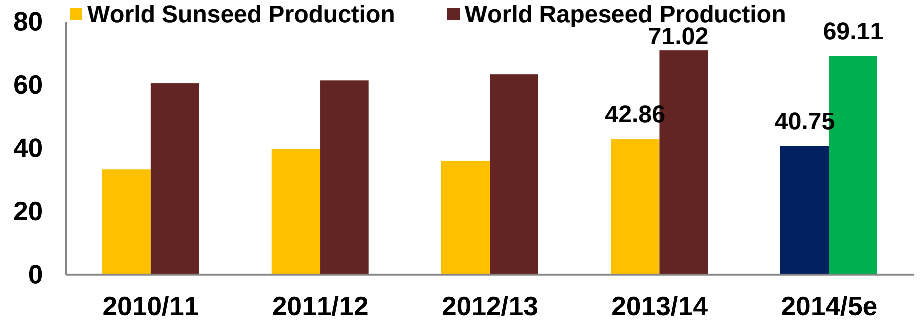
World Oilseeds Production (MMT)
(Source : USDA)



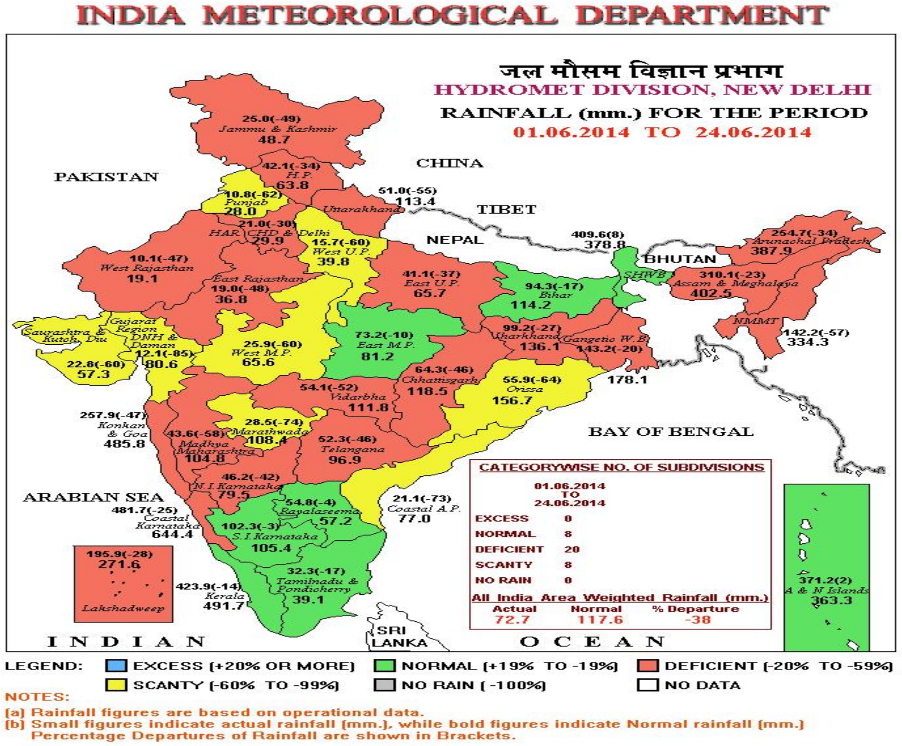
World Soybean Production (MMT)

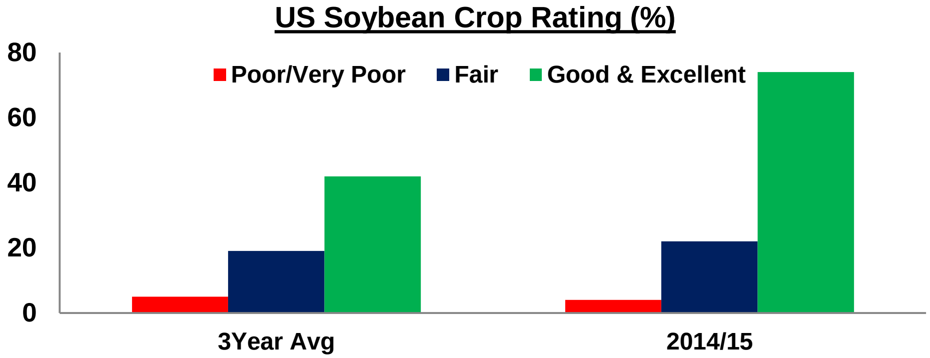


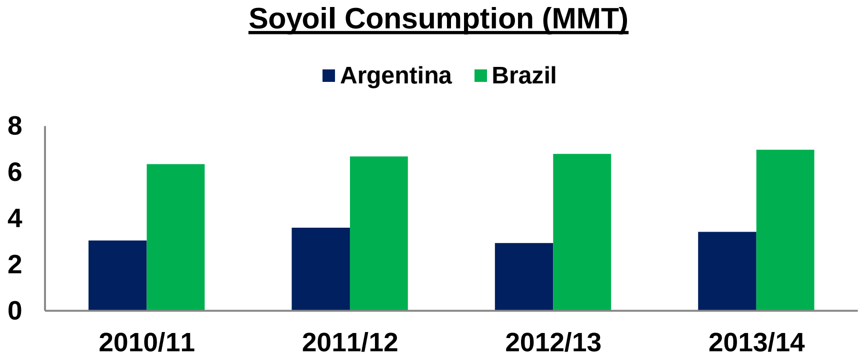
World Sunseed & Rapeseed Production (MMT)



During the oil year there are few caveats which needs to be closely watched (ie) Indian Monsoon which started late but instead of quantum it needs to be watched on distribution, US Soy planting is progressing well, Chinese commodities financing could pause imports & BioD demand in LatAm







Concluding Remarks

- VUCA is and will be new normal and we are at the crucial juncture in setting base for 2H of 2014 global growth in turn would direct currency & commodities

- At the moment ICE is closely watched (ie) Iraq, China commodity financing & El Nino

- LatAm soybean supplies at present crucial as US bins are running out of beans

- DXY to strengthen in 2014 = reverse impact for commodities

- Brent Crude should have broken below $100/bbl mark and headed towards $90/bbl but GeoPoli issue has kept prices elevated. If it gets further intensified it can take prices above $120 levels. Will lead to slowdown in global growth engine but BioD trump card can be played out wellby edible oil producing centres

- Overall veg oil markets are well supplied at present its taking cues from ICE. CPO market structure has changed from deep Backwardation during to Contango. Which was very well played out as views shared @POC 2014. At present prices can catapult towards 2700MYR if Iraq & Weather issue gets intensified but if it remains status quo in that case prices would oscillate between 2350-2550MYR. Break below 2300MYR cannot be ruled out if China growth engine slows down

Thank You

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