

Palm oil in the commodity price cycle

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Making sense of today's markets

I start by showing where prices stand vs long run trends.

Then I turn to the El Niño. Is this one special? Is CPO output responding this time in line with past experience?

How much will world palm oil production fall this year?

How much is it likely to rebound during next year?

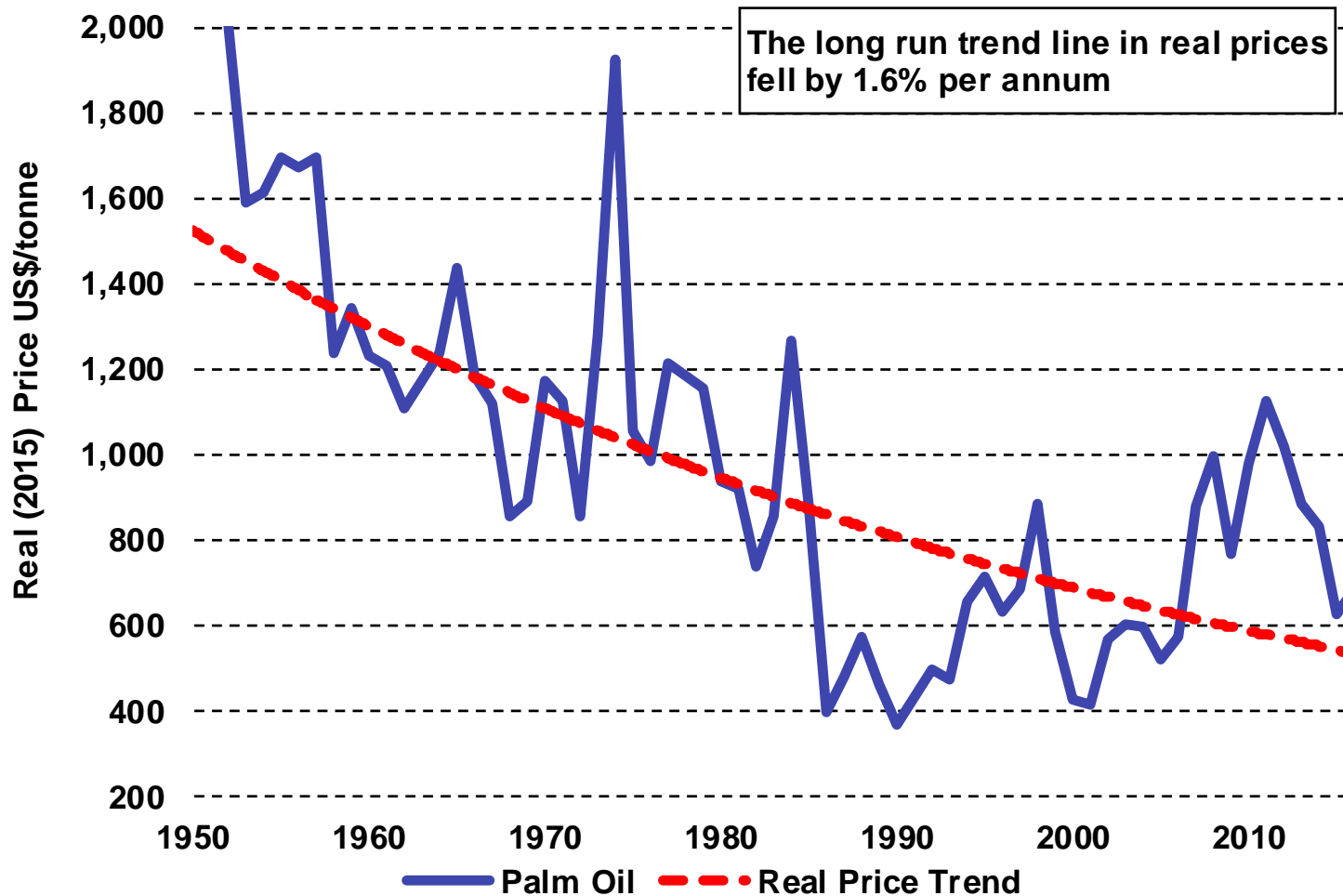
Why didn't prices go higher? The price band is part of the answer as a large spread between vegetable oil and crude oil prices hit biofuel demand. Indonesia's biodiesel mandate played an important role in this.

The availability of other oils, including sales from China's State Reserve, has been the other big factor.

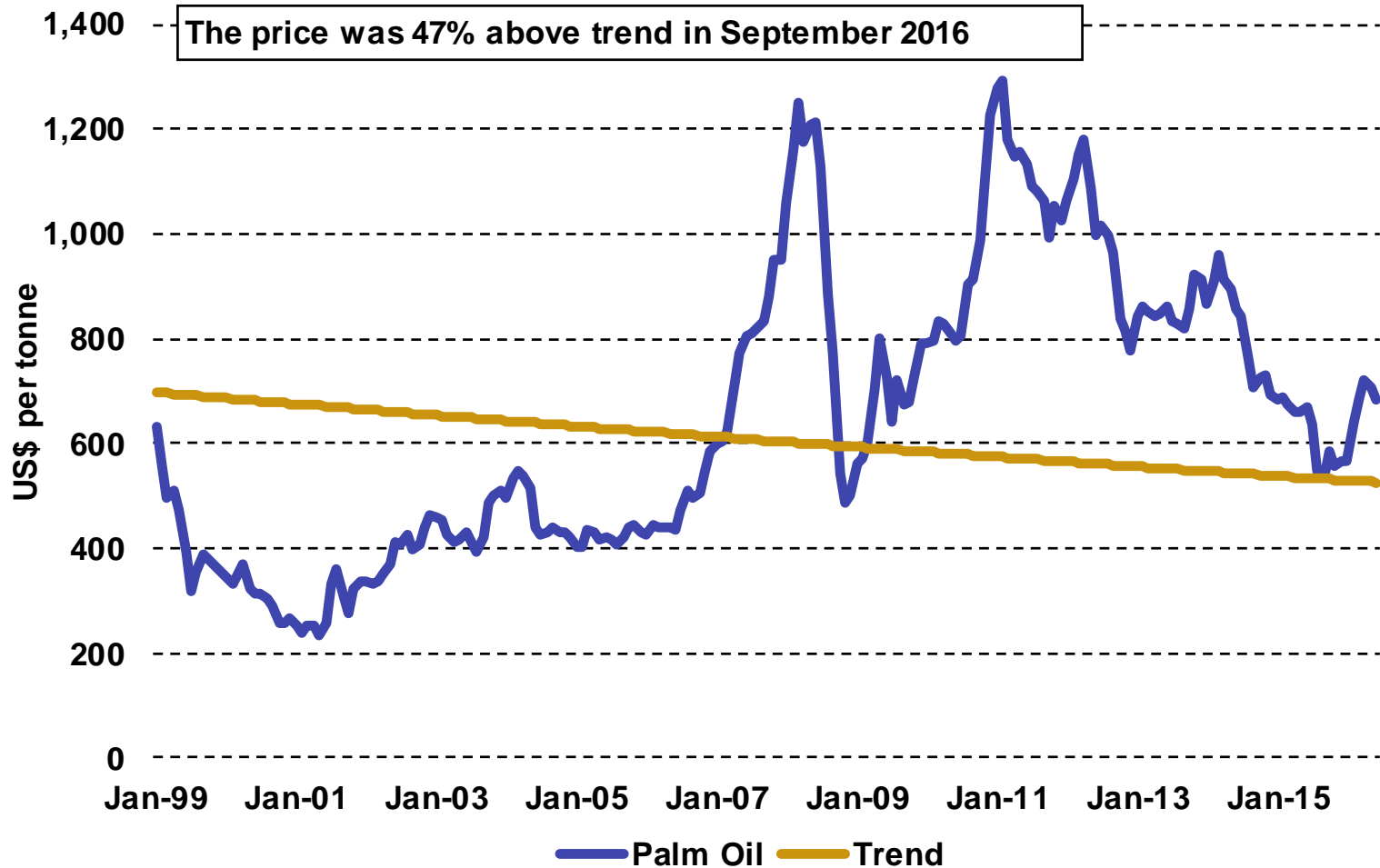
I end with a discussion of the outlook for oils prices.

Putting prices in a long term context

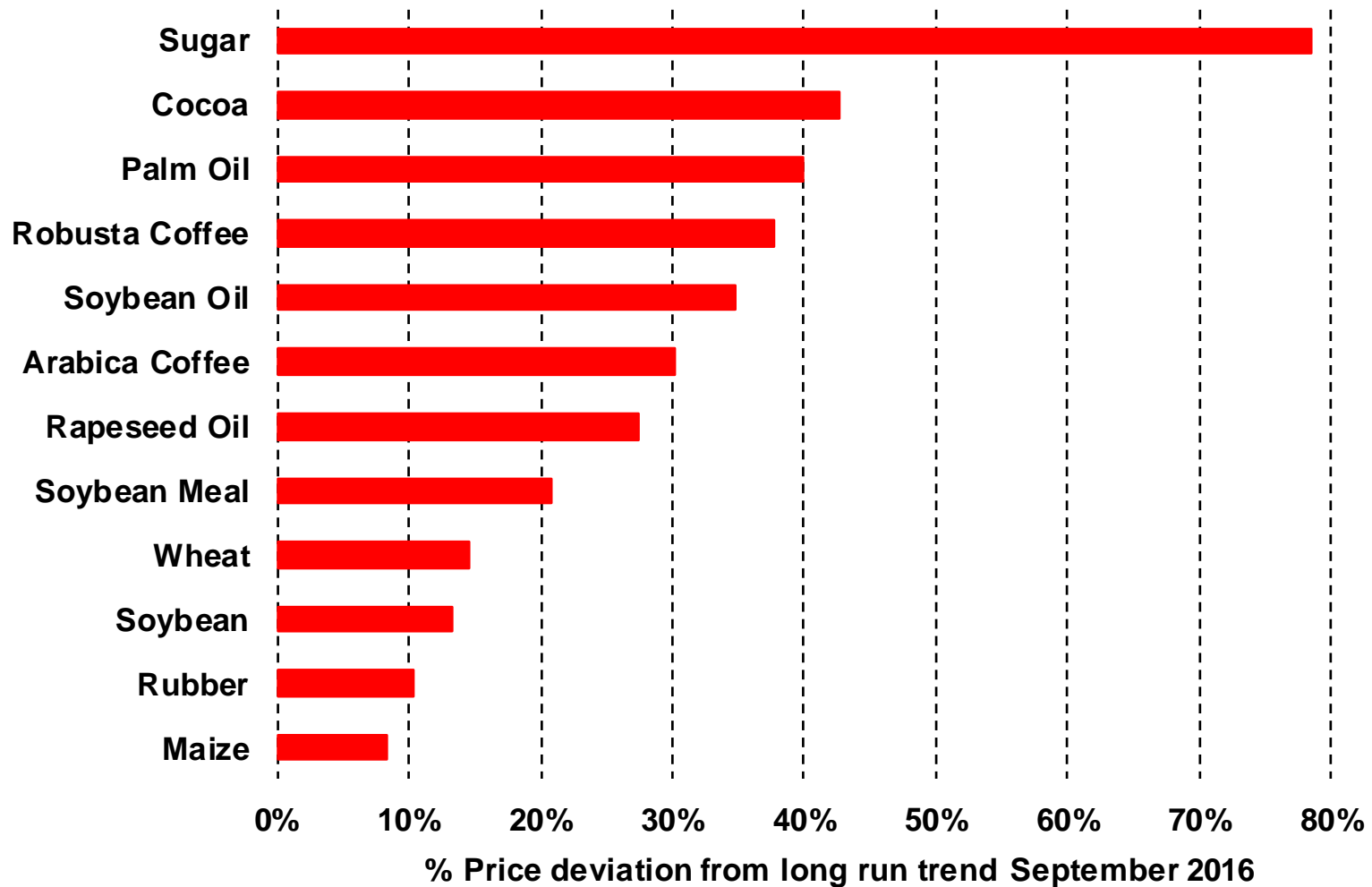
Let's start with the very long term picture. This plots the real (inflation-adjusted) EU CPO price since 1950. It has fallen at 1.6% per year due to rising productivity.



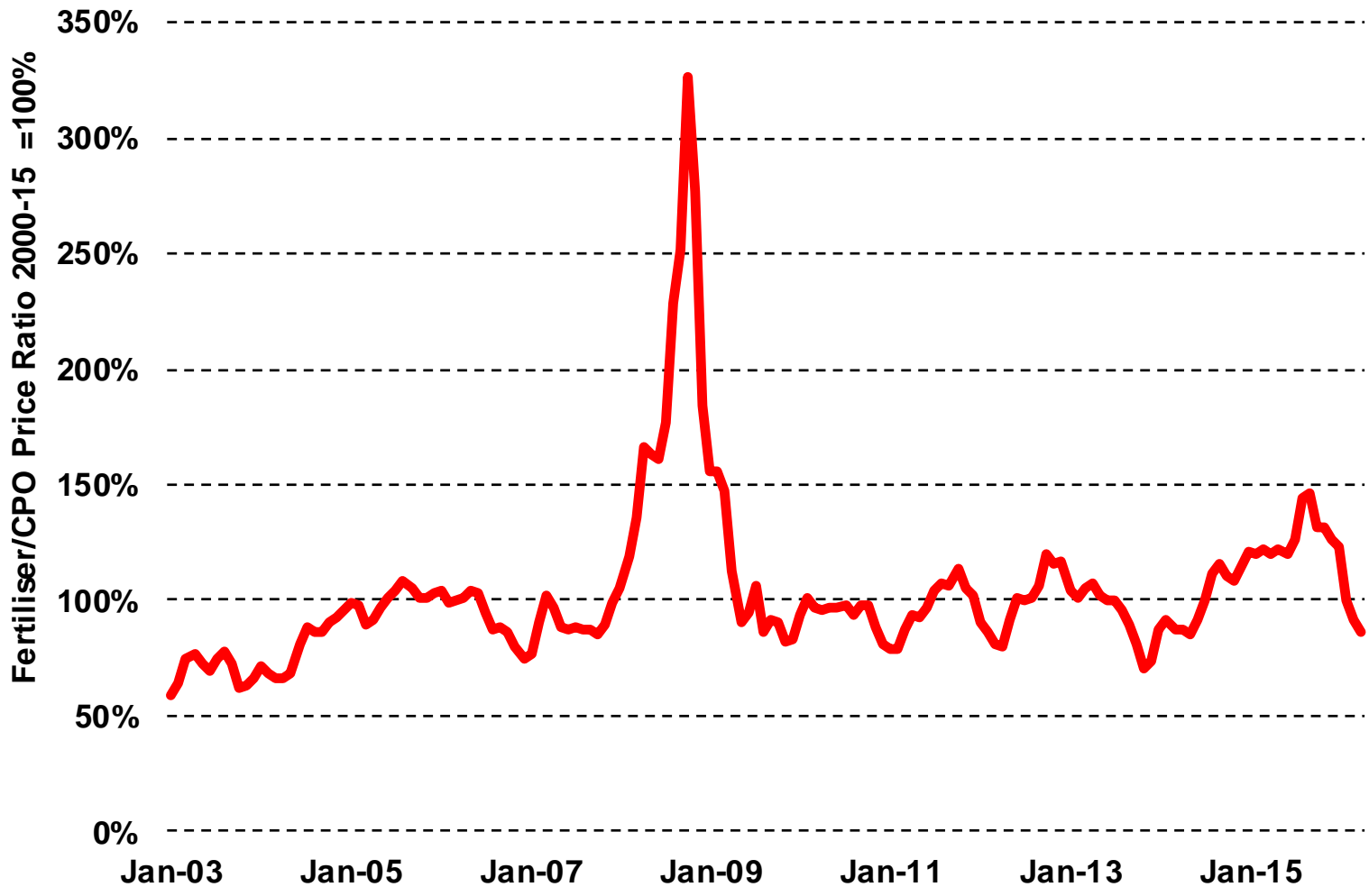
This slide puts recent EU prices into context, showing where they stand vs. their long run trend. Last month the price was 47% above the long term trend value.



For all major agricultural products, September's prices were above, often well above, their long run trends.



One worry for producers is that when crop prices fall, fertiliser prices do not follow suit. In 2008 the fertiliser-CPO price ratio soared. This time was much better.



Where do prices stand today?

People easily get used to a certain level of prices, if they have been fairly stable around that level.

From 2000 to 2006, EU CPO prices averaged less than \$400 per tonne, at one point approaching \$200.

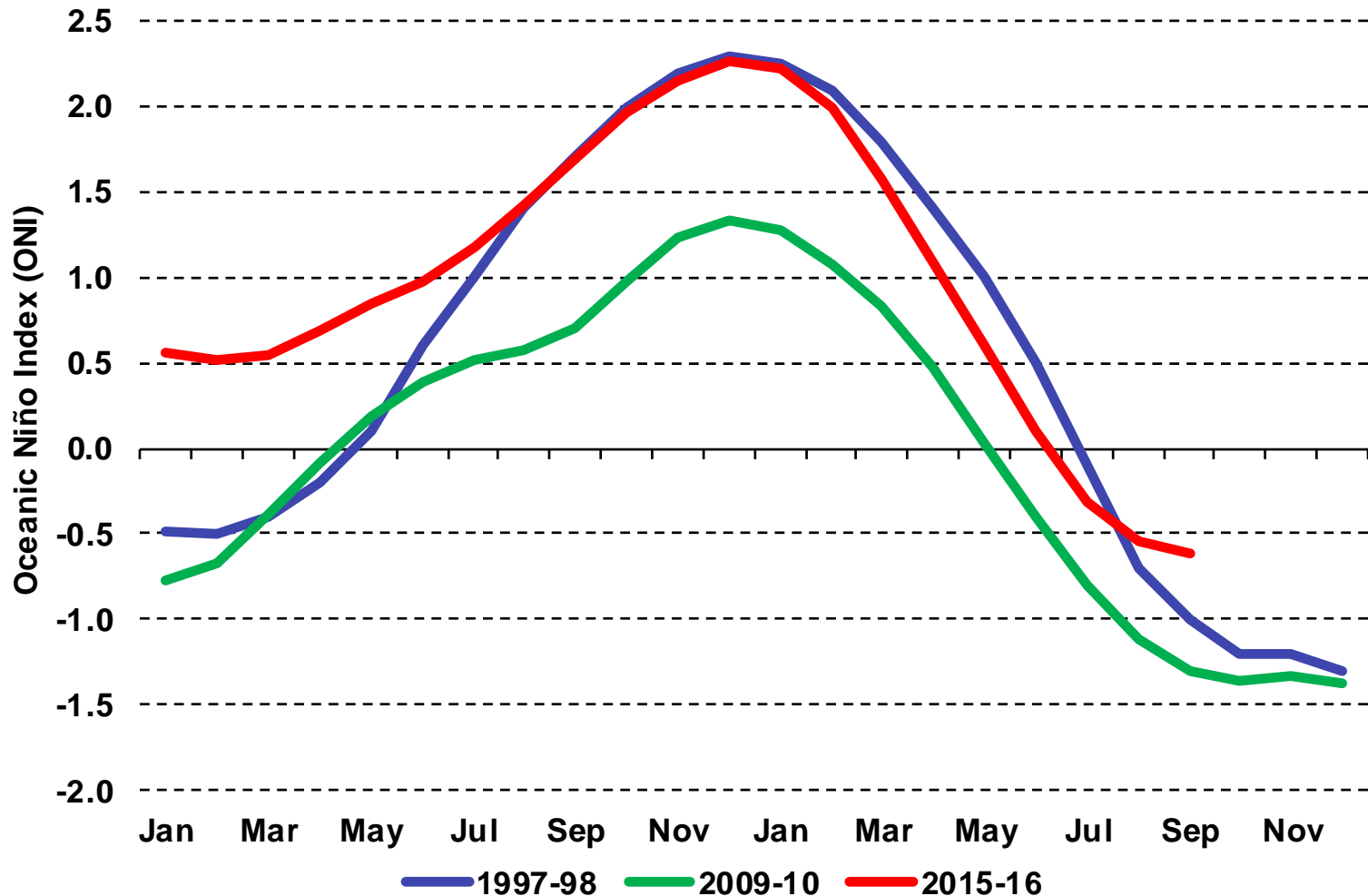
Since 2007, they have averaged \$850, largely, in my opinion, due to the boost to biodiesel consumption.

Most people now expect a slowdown in the growth in biodiesel demand. This suggests that prices will, in normal times and in the long term, without El Niño shocks, tend to trade close to their long run trend.

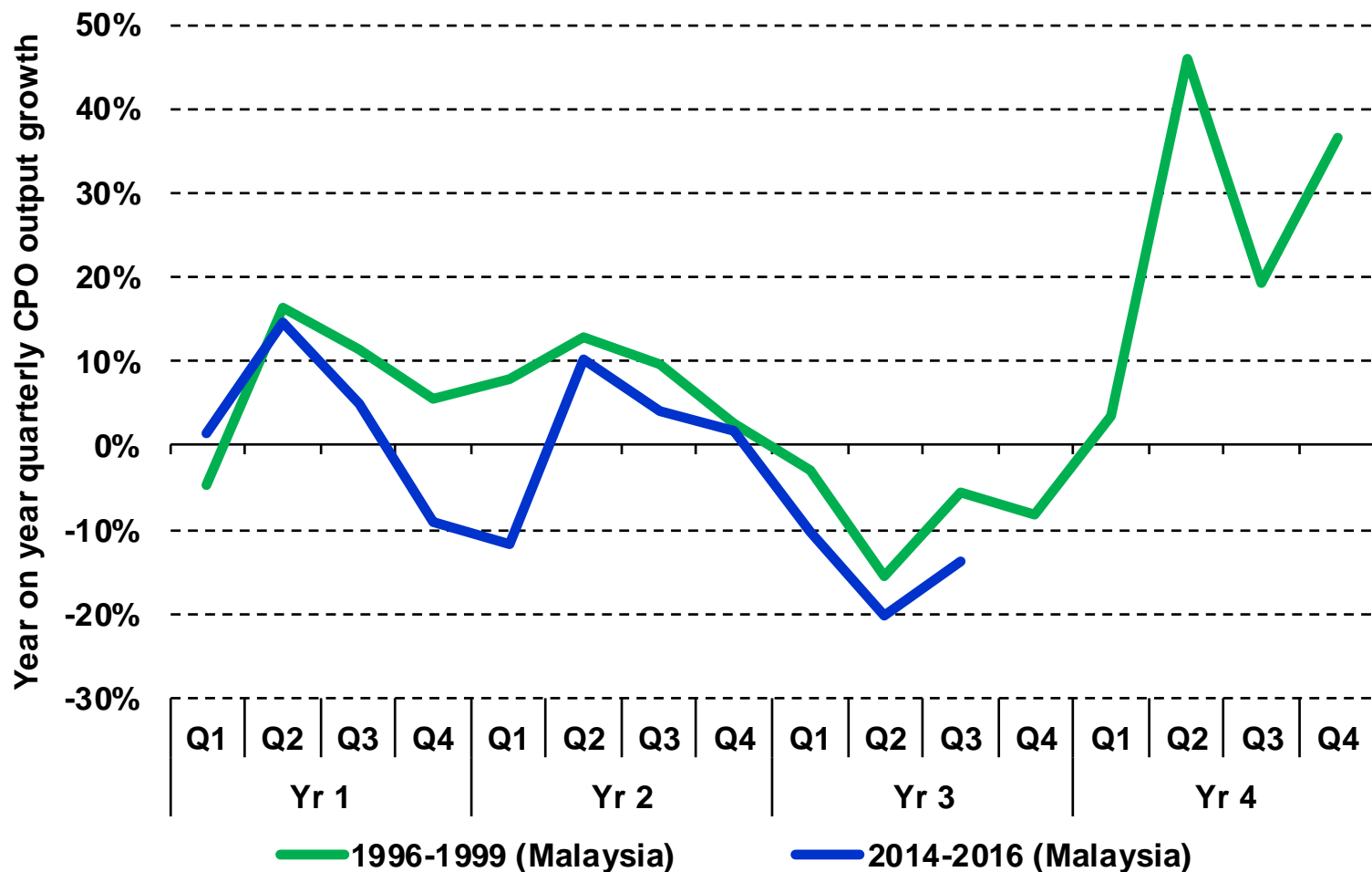
This long run trend in the real CPO price is currently in the region of \$525 per tonne.

The progress of the El Niño and its impact on palm oil production

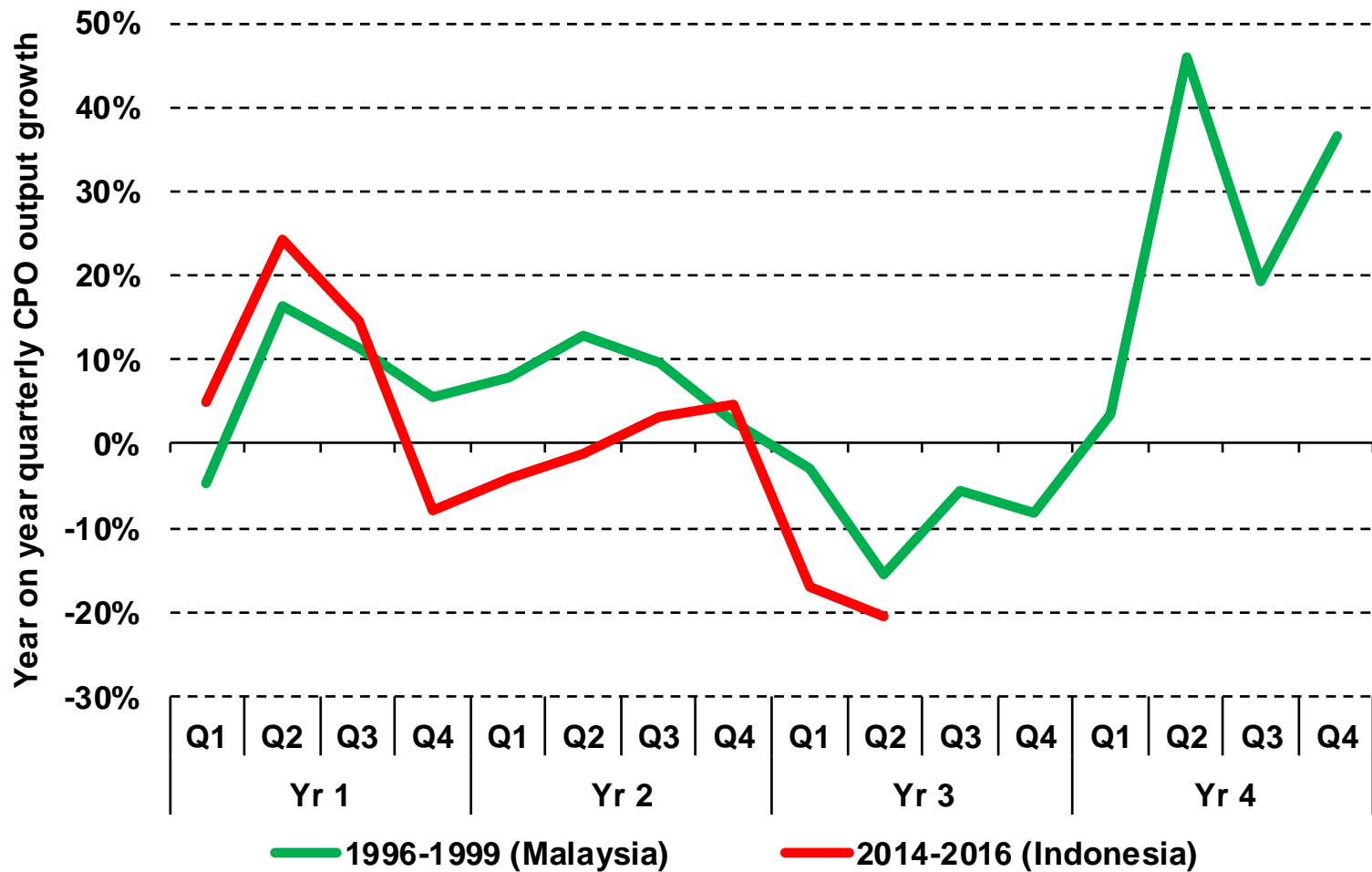
The 2015-16 El Niño closely followed the path seen in 1997-98. However, the ONI curve may be flattening, and so it is unclear whether La Niña is on the way.



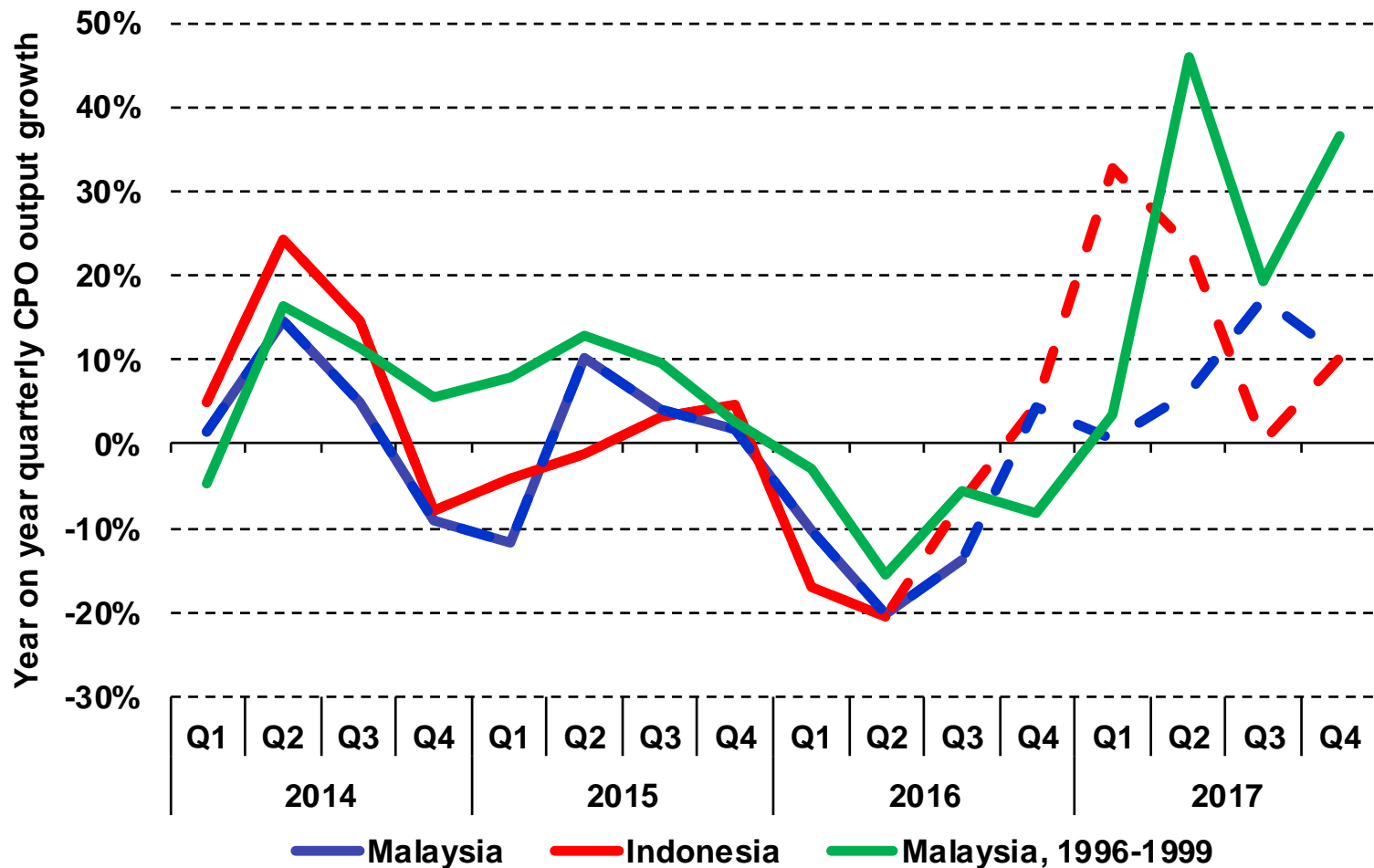
Malaysian quarterly year-on-year growth paths are similar in 1996-99 and since 2014, but growth lags a bit this time, reflecting the slower expansion in areas.



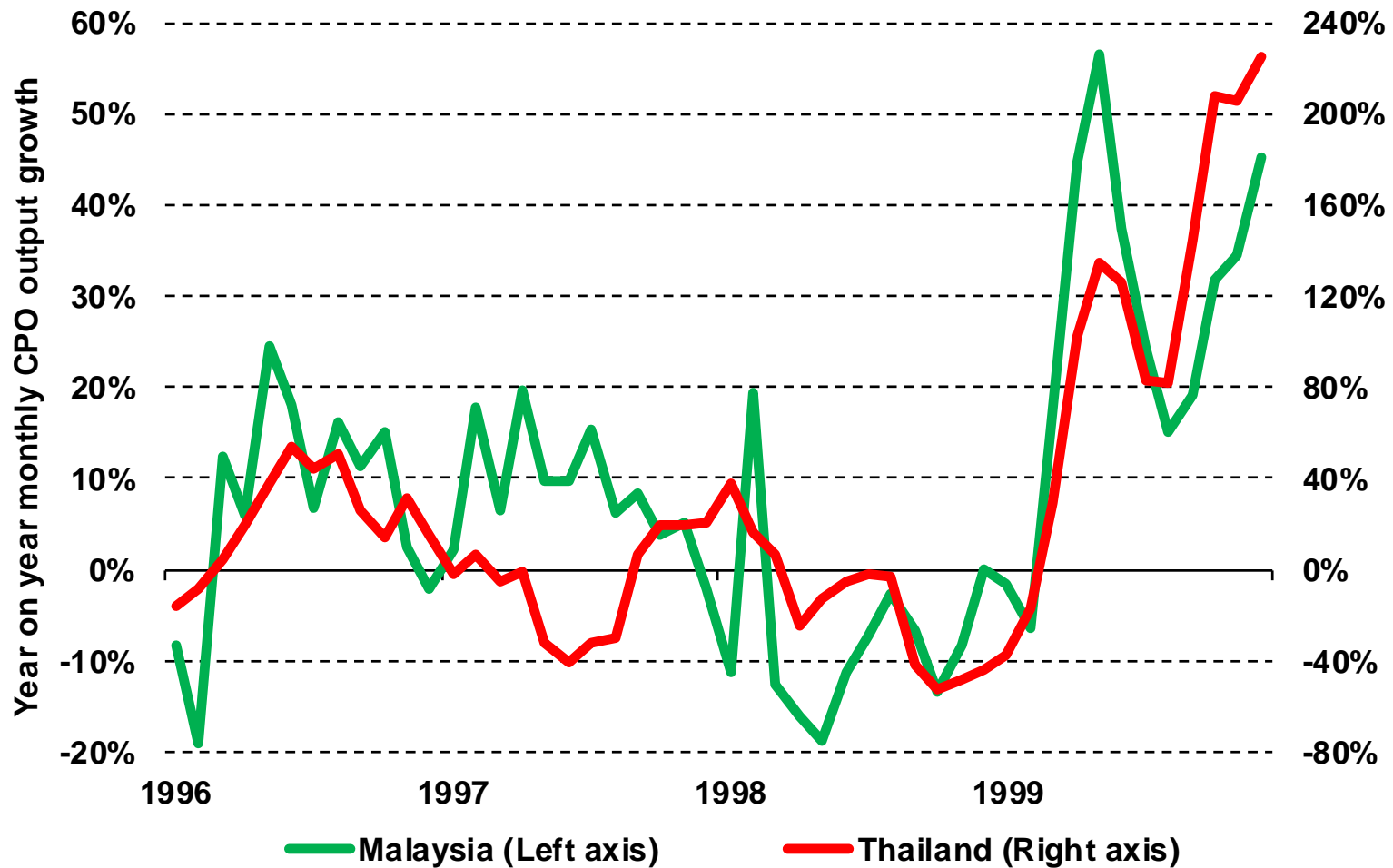
Indonesia's quarterly year-on-year growth path since 2014 is not very different from Malaysia's in 1996-99, but growth has been fairly consistently slower.



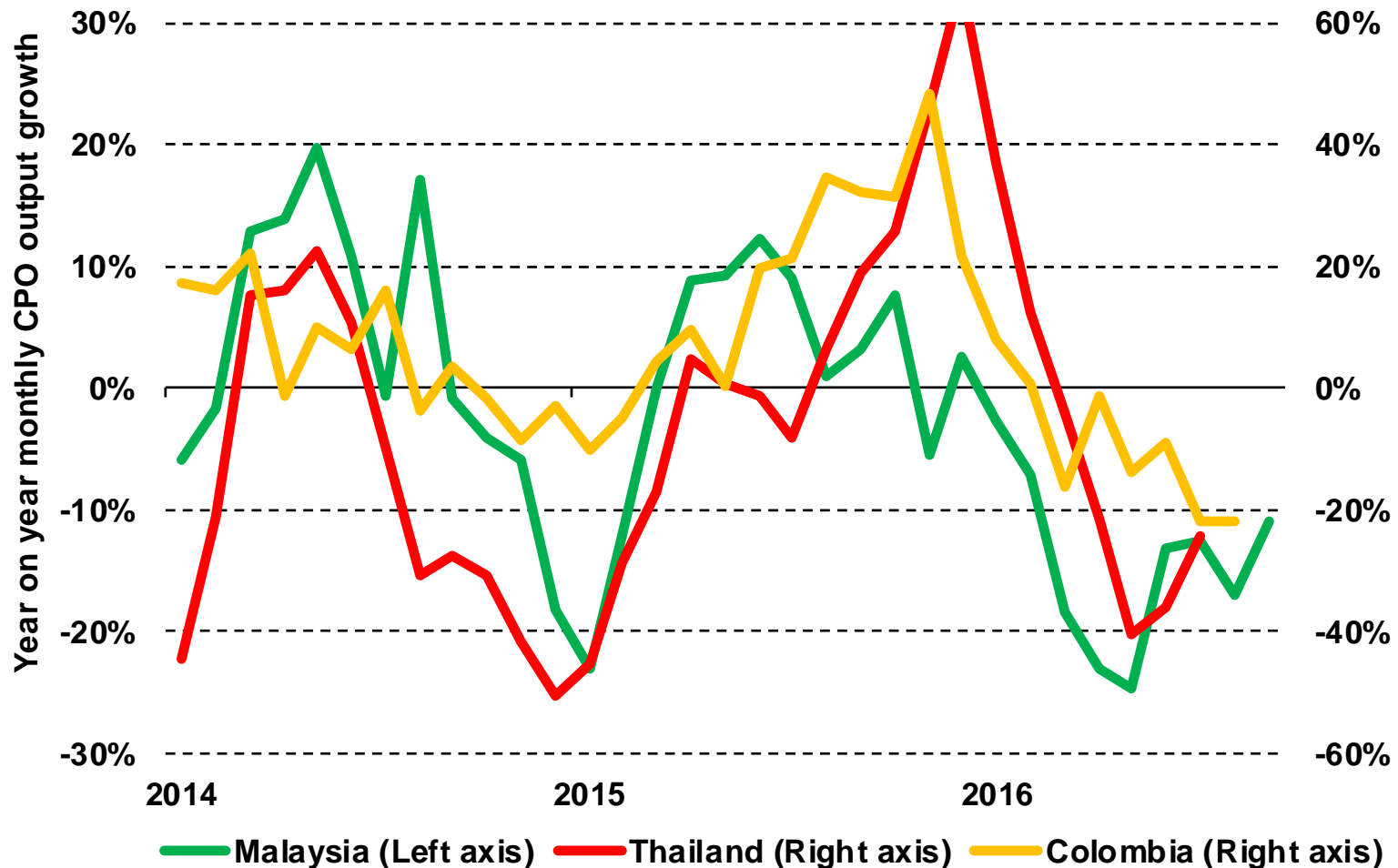
Our forecasts using detailed regional analyses track Malaysia's 1996-99 path fairly closely. They point to year-on-year growth in output by the end of this year.



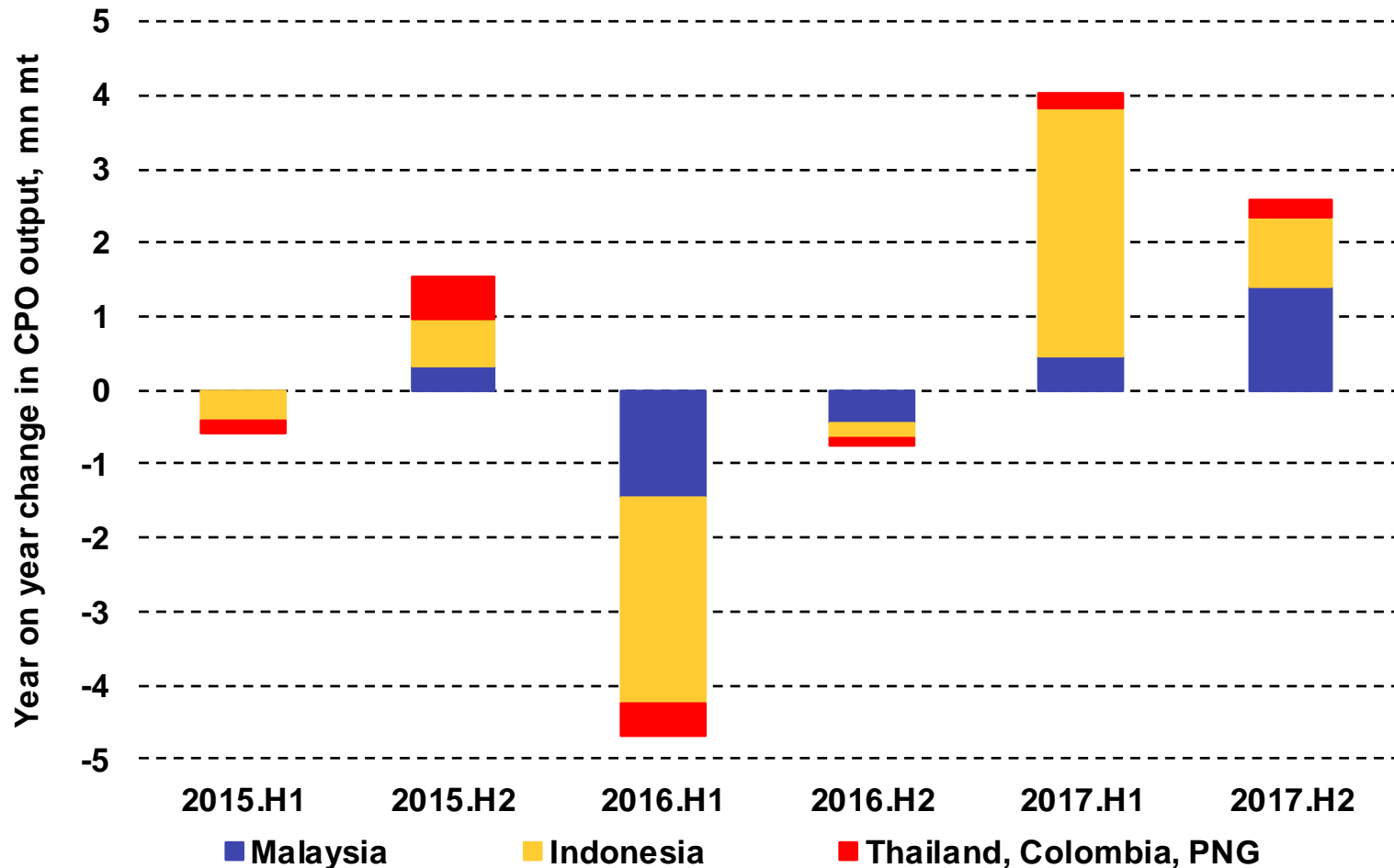
El Niño cycles in CPO production are much stronger in drier regions, such as Thailand: see 1996-1999



Stronger El Niño cycles are also very evident for Thailand and Colombia in the past three years



This plots year-on-year changes in CPO production in the main palm producers by half year. The 2017 H1 rebound will almost offset the 2016 H1 collapse.



The impact of El Niño on CPO output

This El Niño has been at least as severe as the (1997-1999) mega-El Niño. Year-on-year growth rates in the top four CPO producers are all tracking a similar path to that of Malaysia in the 1990s but with the 2014-2016 curves showing slower growth. This slowdown may simply reflect lower pace of the expansion in mature oil palm areas.

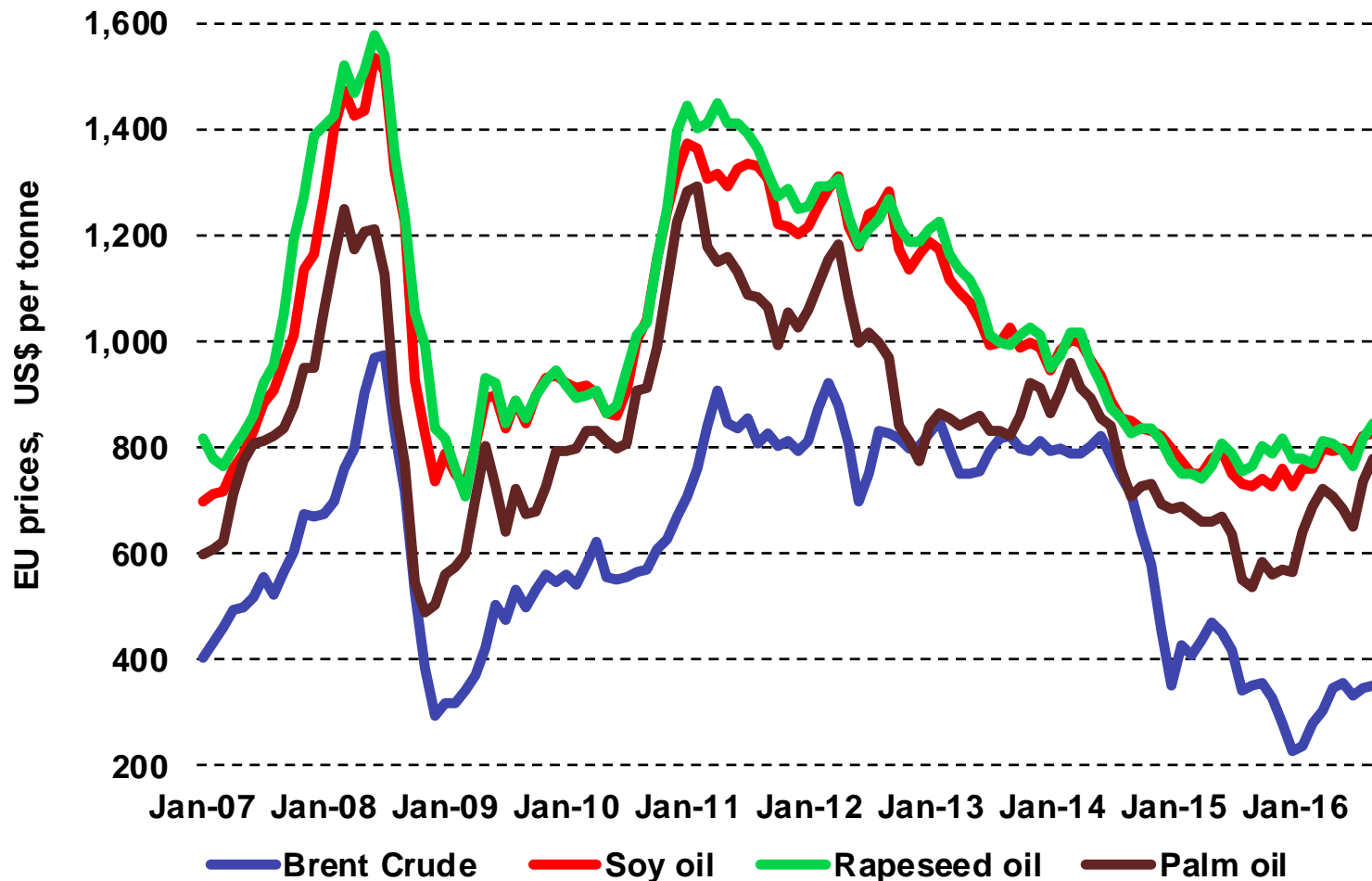
There is some uncertainty about the scale of Indonesia's slowdown. My figures show a 2.8 million tonne fall in Jan-Jun 2016 on 2015, but GAPKI has one of only 1.1 million.

I think that Indonesian output fell 0.6 million tonnes year-on-year in Q3, but is now recovering at an accelerating pace with year-on-year growth of 0.4 million tonnes in Q4.

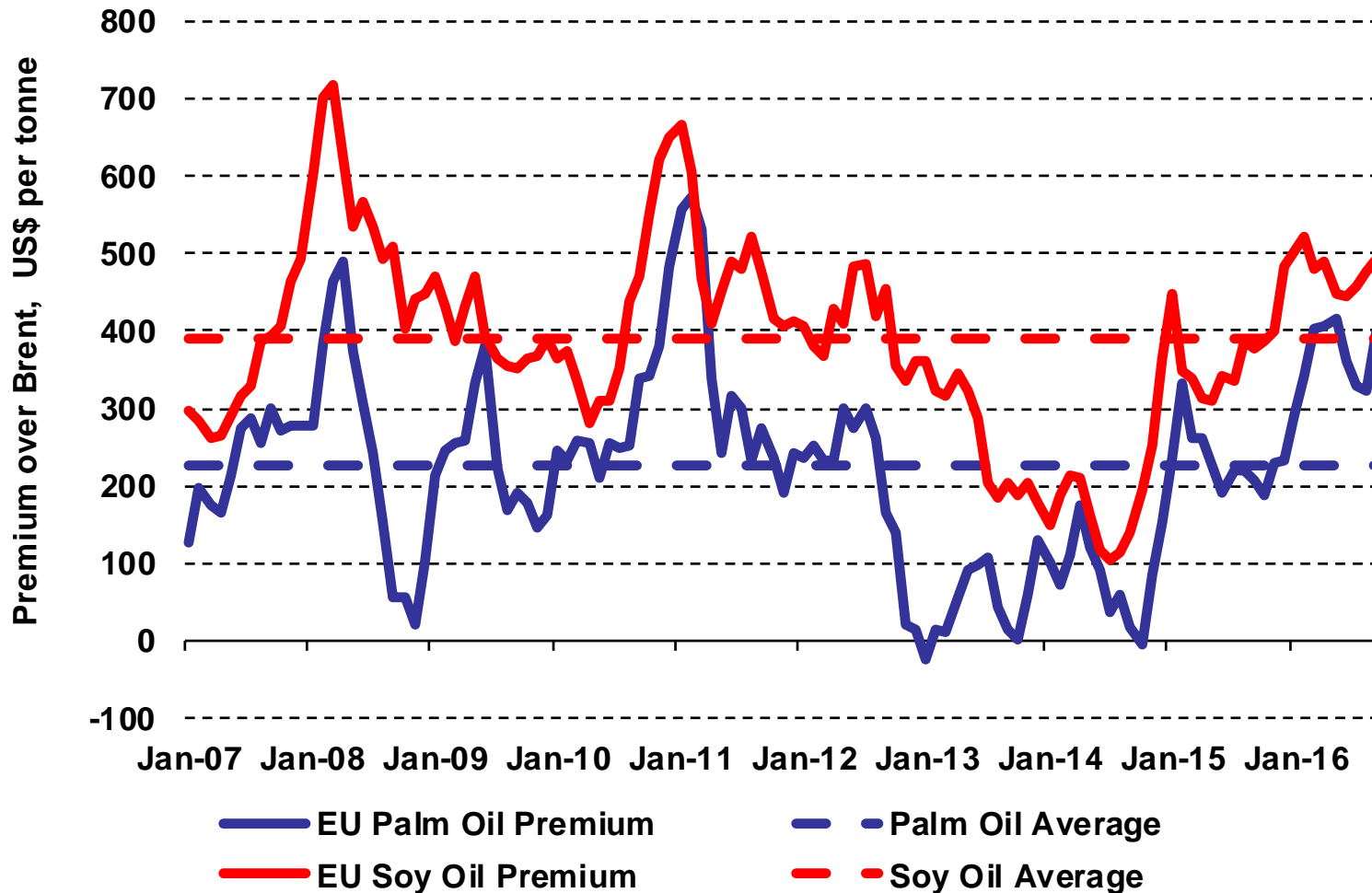
In H1.2017 world CPO output will grow 4 million tonnes.

The price band and palm biodiesel demand

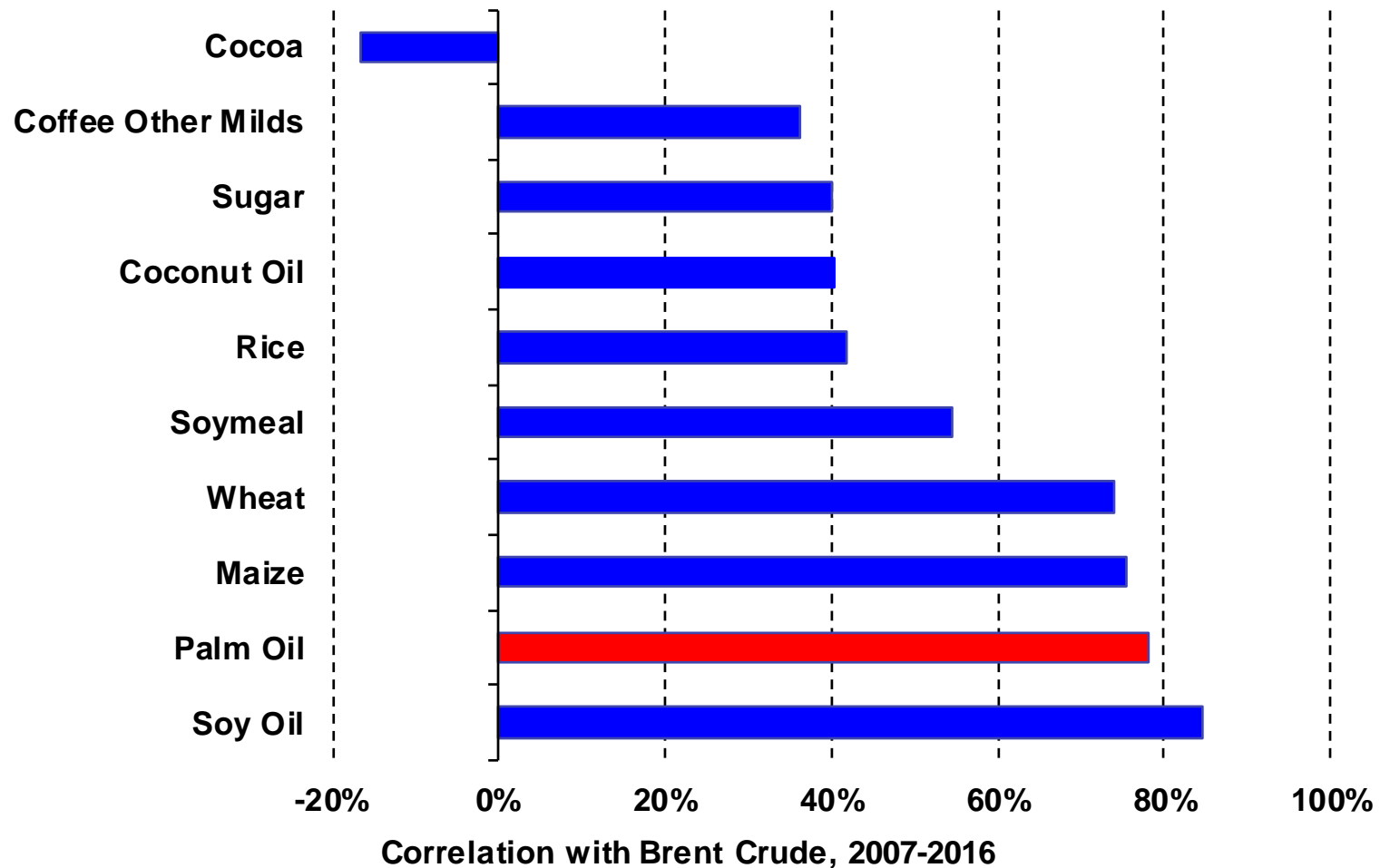
The price band is still there, but as happened back in 2010-2011, the spreads between the prices of vegetable oils and Brent crude are again large.



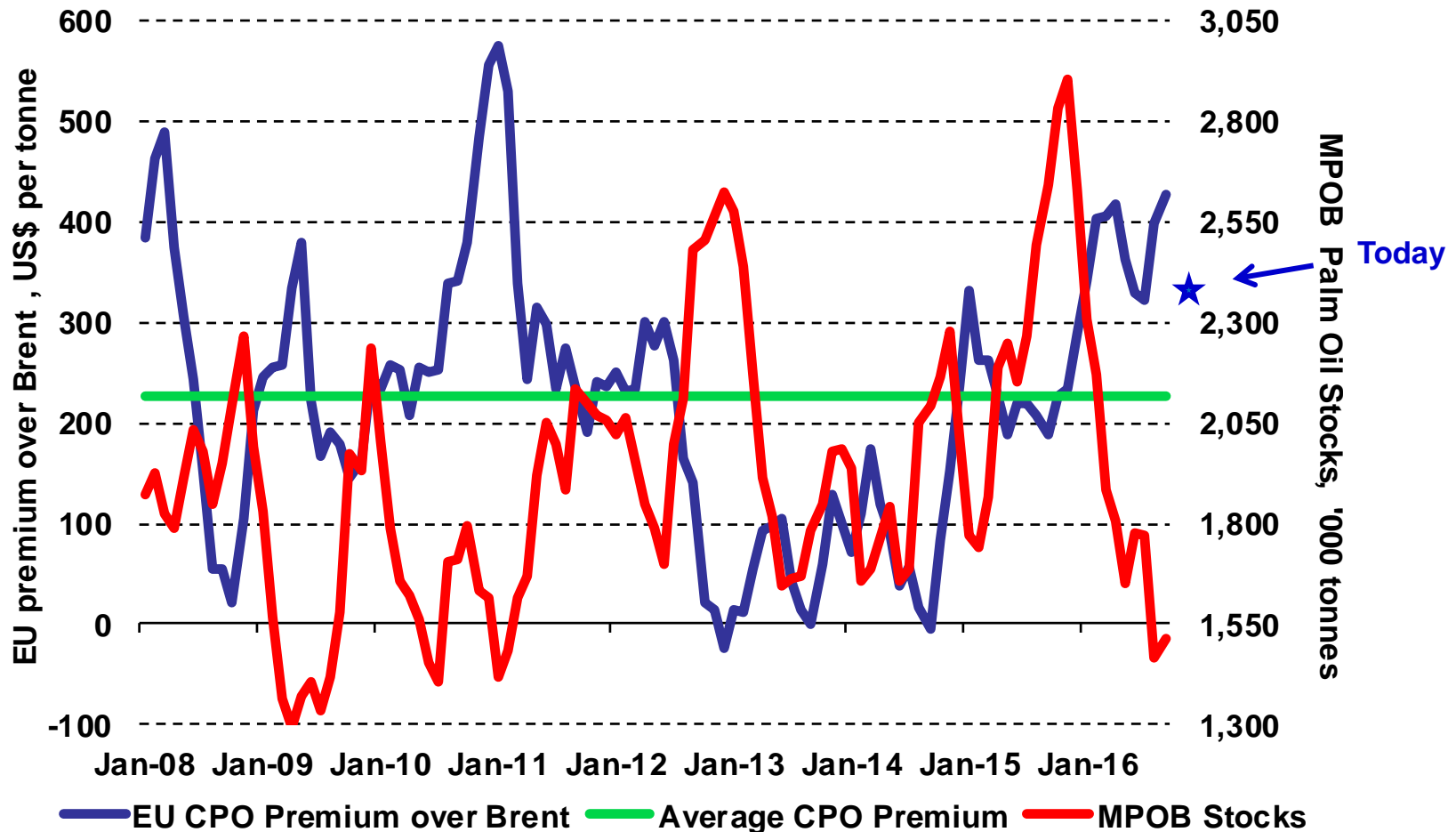
You can see that EU premia of vegetable oils over Brent are well above average, but they have been higher, as happened in both 2008 and 2010-2011.



Fluctuations inside the price band mean that no products have 100% correlations with Brent, but oils have the highest correlations in their monthly prices.

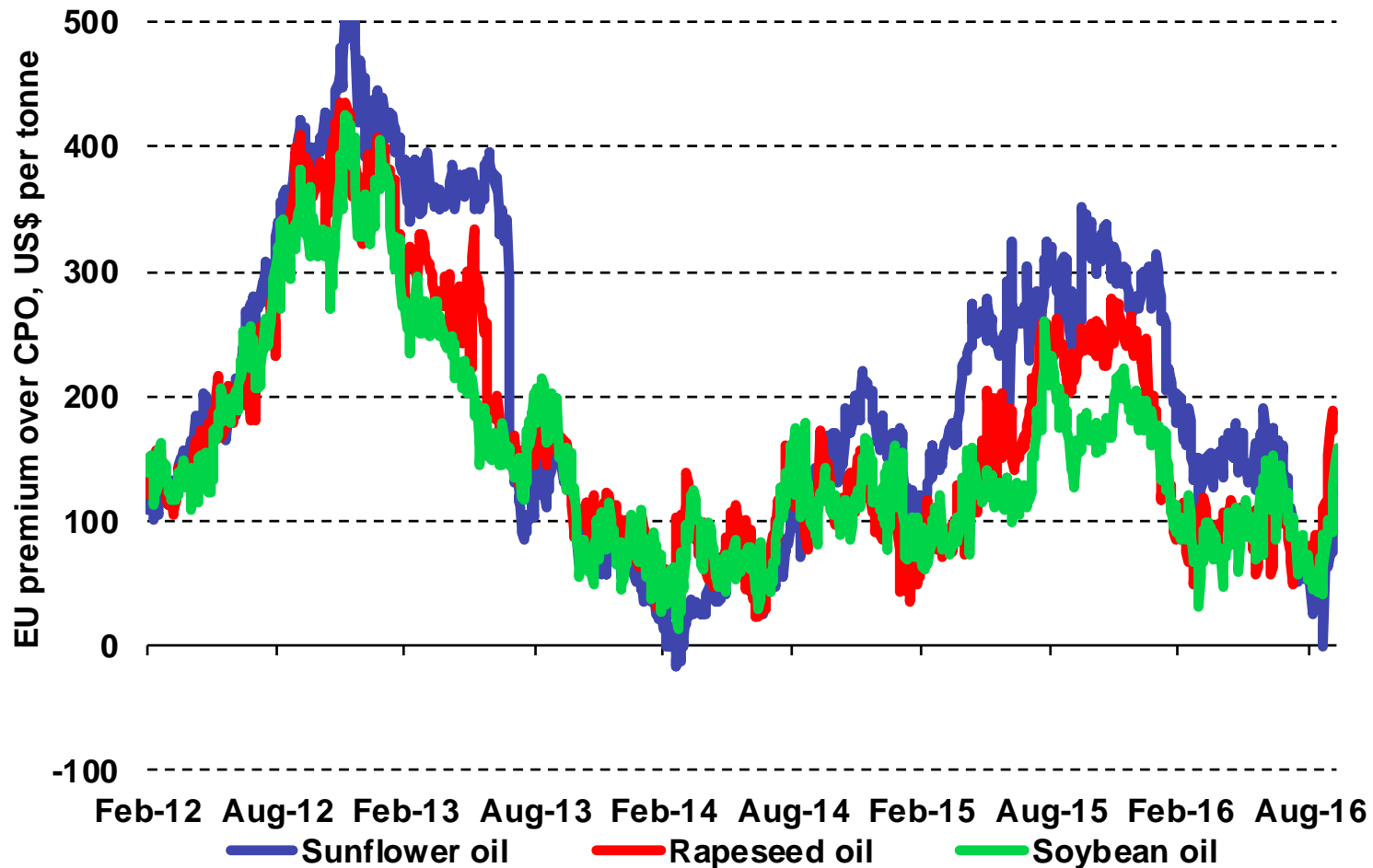


MPOB stocks set the EU CPO premium over Brent, but El Niño concerns kept the premium high despite record stocks last year. Today's premium is \$325.

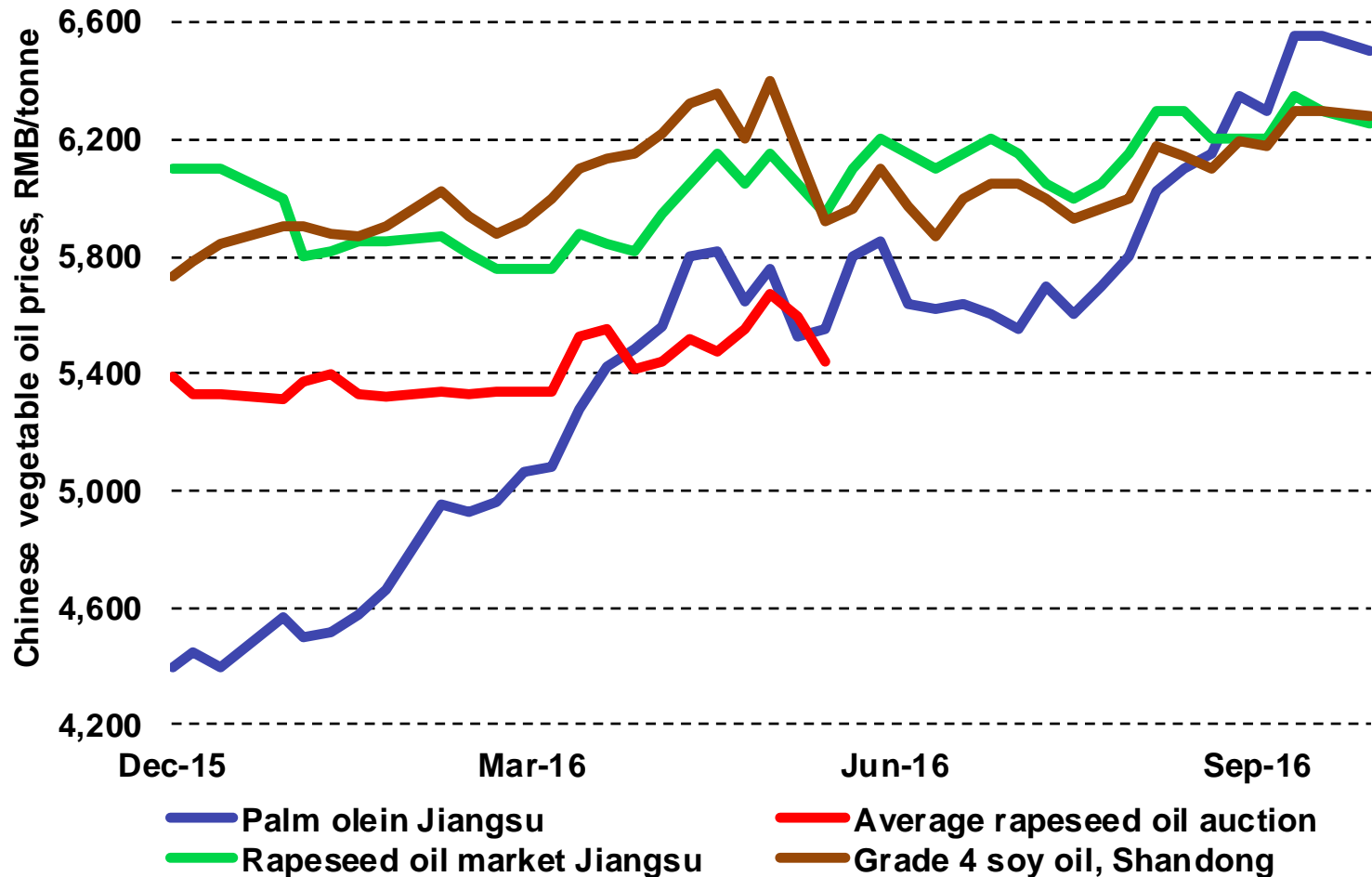


Other factors affecting CPO prices

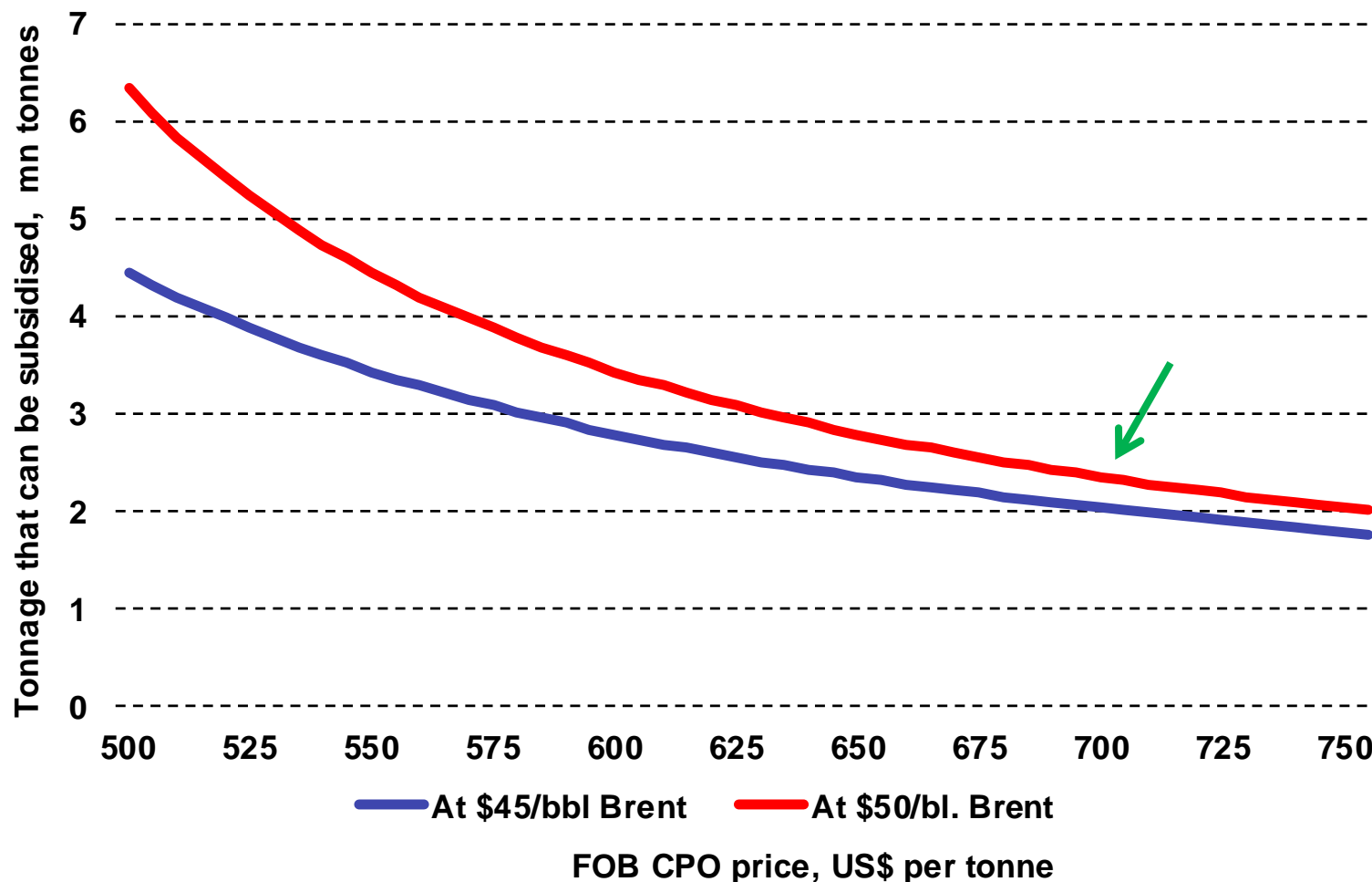
While palm oil prices have been pushing upwards, soft oils prices were steadier, squeezing EU spreads between these oils and CPO until the last fortnight.



A big price influence till June were China's sales of oil from State reserves, now being resumed. They capped local prices. Olein became uncompetitive 6 weeks ago.



Indonesia's biodiesel use depends on the CPO-gasoil spread. At \$45 (\$50)/bbl. Brent and \$700 FOB CPO only 2.05 (2.35) million tonnes a year can be funded.



The outlook for CPO prices

I do not expect Brent crude prices to remain at \$50/bbl. OPEC will not be able to limit output, and another year of oil surpluses is expected. There is also evidence that \$50/bbl. lifts US shale oil production quickly. Therefore I have put \$45/bbl. into my forecasts of the price band.

This means EU CPO will ease to \$675-\$700 in Nov-Dec (i.e., \$625-\$650 FOB and M\$2,400-2,450 BMD), and then move up briefly in Jan-Feb, as MPOB stocks fall with lower monthly production on a seasonal basis.

EU CPO will fall to \$600 (\$550 FOB/M\$2,100) in the second half of 2017, with S.E. Asian output surging and stocks doing the same as El Niño's impact vanishes.

If Brent does stay at \$50, add M\$150 to these forecasts.

Thank you

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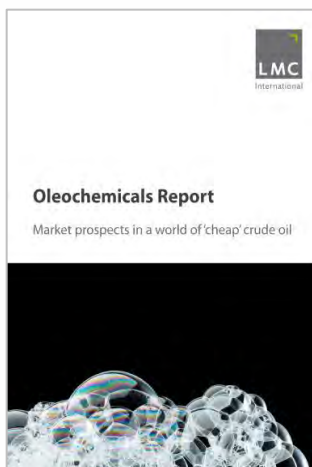
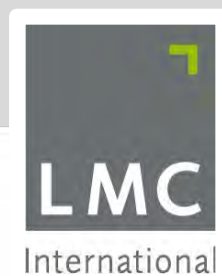
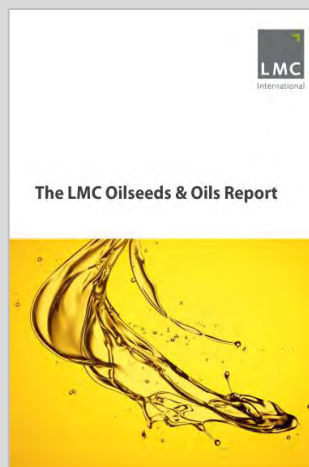
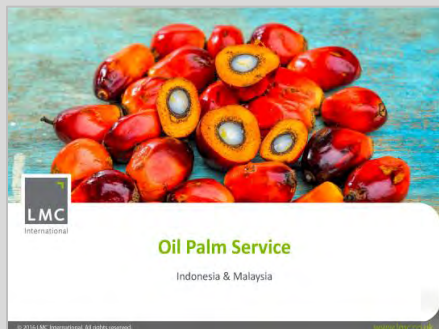
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