



Palm Oil Industry: Sustained Supply, Subdued Demand and Pressure on Prices

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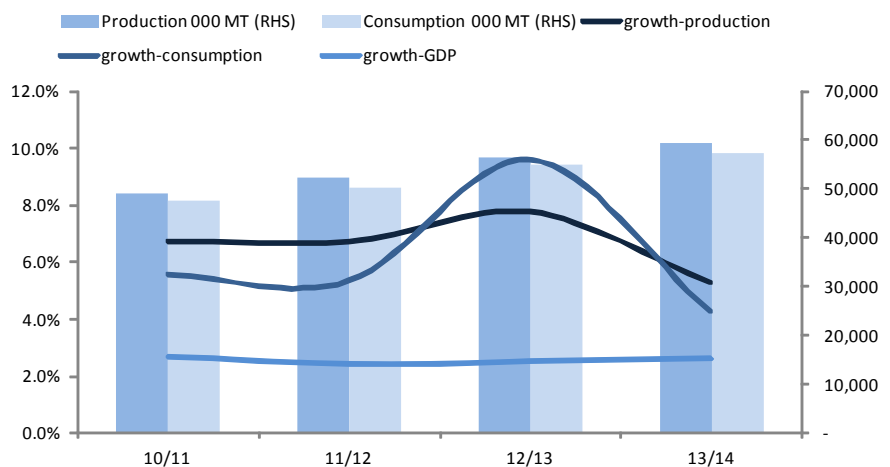
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Global production is in tandem with the consumption

The growth in global palm oil production to date is in tandem with the growth in consumption. Palm oil production recorded a compounded annual growth rate (CAGR) of 6.6% in the last five years to about 59.5 million Metric Ton (MT) in 2014 which is comparable with consumption growth of 6.2% to around 57.3 million MT in the same period. In this case, the growth in the production and consumption of palm oil surpassed the GDP growth in the world economies reflecting sustained palm oil importance in the global market. Steady increase in palm oil consumption was mainly attributed to growing population and economic activities while supply was sustained by an accelerating palm oil production especially in the world's two largest Crude Palm Oil (CPO) producers, Indonesia and Malaysia.

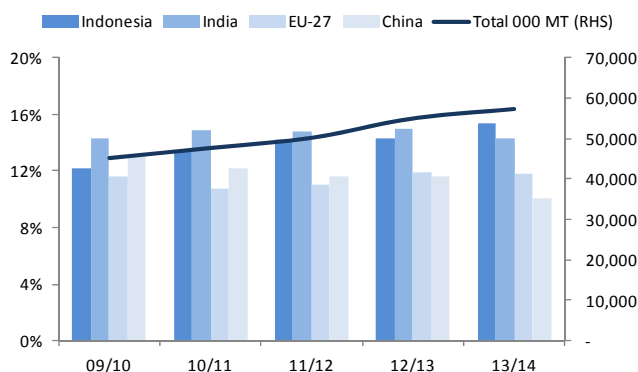
Exhibit 1 Palm oil's supply & demand



Source: World Bank, USDA (2014:world GDP estimation)

Palm oil market is dominated by four countries/union namely Indonesia, India, European Union (EU) and China which have consumed more than 5.0 million MT per annum respectively since 2010. They altogether commanded a market share of about 51.7% on average during 2010-2014 and recently at 53.3%. Significant palm oil consumption in three leading emerging markets in Asia (Indonesia, India, and China) was attributable to their huge population coupled with growing GDP in the last few years. Meanwhile, despite recording much slower economic growth compared to those emerging countries, uptrend palm oil consumption in the EU countries was backed by their commitment to increase the implementation of bio-fuels apart from other application for food and cosmetics.

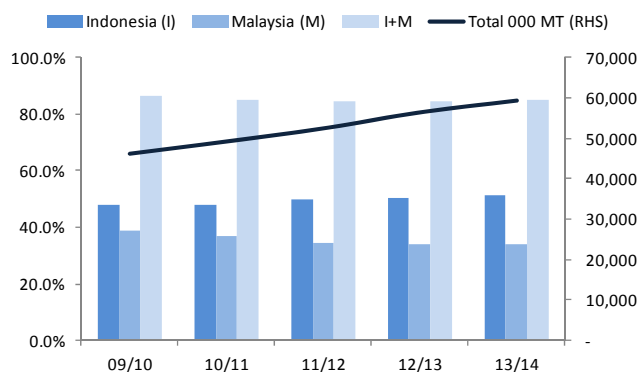
Exhibit 2 Palm oil consumption



Source: USDA

Palm oil consumption in Indonesia has recorded a significant CAGR of 12.5% to about 8.8 million MT in 2014 or the biggest in the global market. Others such as India and EU countries also booked an increase in palm oil consumption however at a slower pace of 6.2% and 6.6% to around 8.2 million MT and 6.8 million MT, respectively. Meanwhile, the decline in palm oil consumption in China of 0.8% CAGR to about 5.8 million MT in 2014 was mainly due to the economic slowdown domestically whose GDP is estimated to grow at merely 7.4% last year (vs. 7.7% in 2013). China's palm oil consumption started to decrease in 2014.

Exhibit 3 Palm oil production

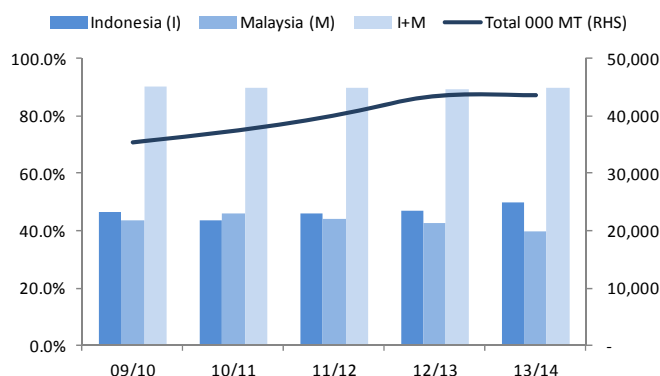


Source: USDA

Palm oil cultivation is typically located at zones lying within ten degrees latitude to the north and south of equator which include West Africa, Central & South America, and South Asia particularly Indonesia and Malaysia. Having the biggest palm oil production scales has put Indonesia and Malaysia as the dominant producers in the global market. Both countries collectively accounted for about 85.2% on average of the world's CPO output during 2010-2014. In 2014, Indonesia and Malaysia produced palm oil of around 30.5 million MT and 20.2 million MT with a CAGR of 8.5% and 3.2%, respectively.

In tandem with their dominant market shares in world palm oil production, Indonesia and Malaysia also had a leading combined export market share of 89.8% on average in the last five years. Palm oil export from Indonesia was up by 7.0% CAGR to around 21.7 million MT in 2014 which is higher than Malaysia's about 17.3 million MT and 2.8% CAGR. Indonesia's palm oil production was mainly exported to India, EU, and China whose total market share was 49.4% on average during the last five years.

Exhibit 4 Palm oil export

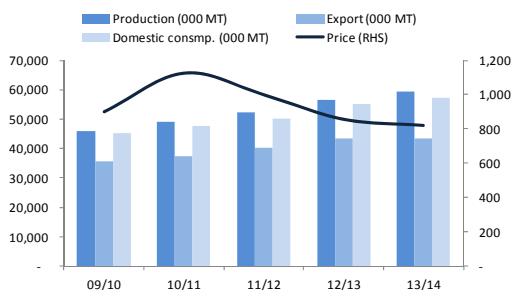


Source: USDA

Proven competitive advantages against its substitutes

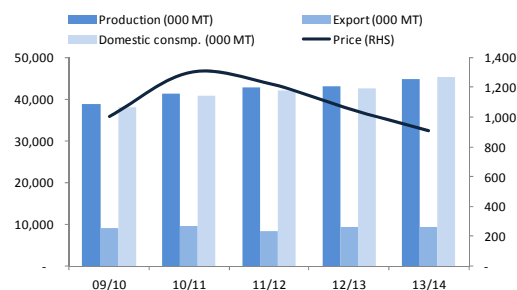
Palm oil is widely used in the global market for various applications. In many countries, it is used as simple frying oil. However many other markets make use of both palm and palm kernel oil (PKO) for consumer retail food and snack manufacturers; personal care and cosmetics (mainly PKO); biofuel and energy; animal feed (palm kernel expeller); pharmaceutical; industrial; and food service industry. Harvested all year round, oil palm trees produce on average 10 tons of fruit per hectare - far more than soybean, rapeseed and sunflower crops (source: greenpalm.org).

Exhibit 5a. Palm oil



Source: USDA

Exhibit 5a. Soybean oil

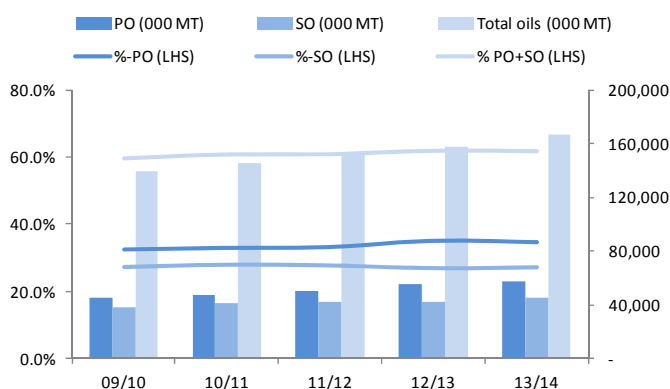


Source: USDA

Supply and demand of soybean, its closest substitute, was still lagging compared to palm oil. Global production, consumption and export of soybean stood at about 45.0 million MT, 45.3 million MT and 9.4 million MT in 2014 which was lower than palm oil (59.5 million MT; 57.3 million MT; and 43.6 million MT). Henceforth, palm oil was more widely used in the global market given its various product derivatives backed by its bigger production scale and highest yield compared to other types of vegetable oils. The oil palm currently yields an average of 3.7 MT/ha of oil per year, which is 2.5 times higher than rapeseed and about seven times more than soy (Oil World).

Moreover, palm oil also offered more affordable price compared to soybean as its average price in 2014 stood at a lower level of USD 821.4/MT (vs. its substitute average price of USD 909.3/MT). The similar price movement of the both vegetables oils was inseparable from their prominent role as the biggest contributor of world vegetable oils in the world. The average ratio of combined palm oil and soybean oil consumption to total world vegetable oil consumption was about 61.0% during 2010-2014. Palm oil itself has dominated the consumption with market share about 33.5% on average compared to soybean's 27.5% in the last five years.

Exhibit 6 Palm oil & soybean oil's world consumption



Source: USDA; (PO=palm oil, SO=soybean)

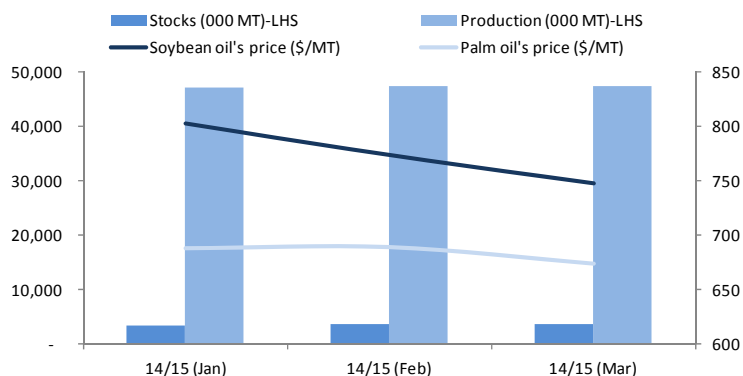
Pressures on price amidst sustained supply

It is predicted that palm oil price will be under pressure during this year provided the following:

Increase in soybean's stock globally backed by growth in production

At end of March 2015, the production of soybean was up to about 47.4 million MT (vs. 47.1 million MT in January) mainly backed by harvest season in Argentina. In turn, it increased the global stock to around 3.6 million MT (vs. 3.3 million MT in January). This substitute's higher level of production and stock has eventually put pressure on the CPO price. Sustained soybean supply in the global market will continue to impact the price of palm oil price despite the fact that normally second-half yields of palm oil would be affected by scattered dryness.

Exhibit 7 Soybean oil

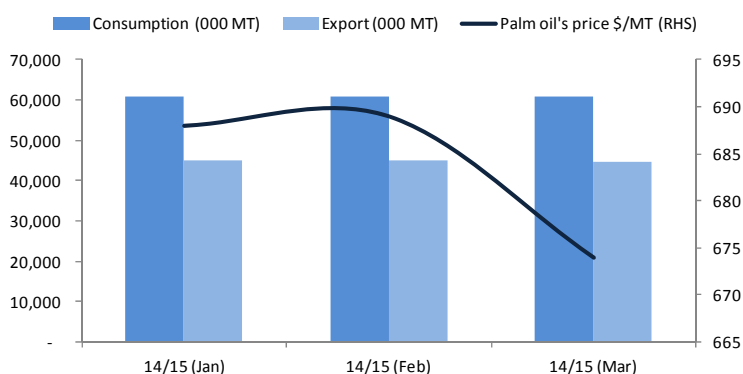


Source: USDA

Subdued demand along the global market

A slowdown in the global economy was reflected by a lower than expected China's GDP annual growth rate of 7.0% in the first quarter of 2015, lower than previous quarter of 7.3%. In fact, it was the lowest growth recorded since 2010. On a global perspective, the World Bank has also revised down the world GDP growth to 2.6% from its initial forecast of 2.8% for 2015. In tandem with the slowdown in global economy, demand for palm oil was also in declining trend in the last three months despite the sustained production.

Exhibit 8 Palm oil world consumption & export



Source: USDA

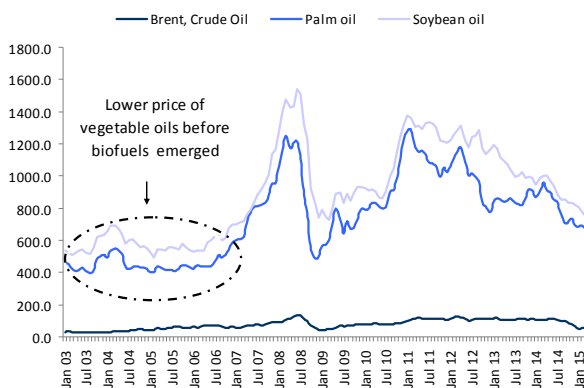
Global consumption of palm oil was recorded at around 60.7 million MT in March compared to 60.8 million MT (February), and 60.7 million MT (January). In line with this trend, total export of this commodity slipped to about 44.6 million MT in March (vs. 44.9 million MT in February and January). In addition, ending stock of palm oil in the global market stood at around 7.3 million MT in March, slightly higher compared to February of about 7.2 million MT. Looking at this trend, it is estimated that global consumption of palm oil will only grow to about 59.1 million MT, or up by 3.2% yoy taking into account the global economic slowdown.

Price will get affected

Looking at the historical data, palm and soybean oils were transacted at lower prices of below USD 600/MT and USD 700/MT before biofuel emerged in 2007. The prices of these commodities heightened especially in March-August 2008, hovering at about USD 1,060-1,249/MT when the fossil fuel price was transacted at the range of USD 103-134/barrel. An exception of significant drop to USD 488.0/MT and USD 738.0/MT for palm oil and soybean oil prices in 2008 was mainly as an impact of the global crisis triggered by subprime mortgage issues in the US market. Amidst the slowdown in global economy which was reflected in the subdued demand on commodities, palm oil was transacted at lower prices of about USD 683.7/MT on average during the first quarter of this year. Crude oil and soybean oil were also down to about USD 53.9/barrel and USD 774.0/MT on average in the same period. For the year of 2015, it is estimated that palm oil price will remain under pressure and hover at around USD 650-700/MT amidst sustained supply and slowdown in global economy.

The weather phenomenon such as El Nino may have a positive impact on prices for the reduced supply due to the massive drought. However, at the moment it is too early to measure the impact as the coming of El Nino this year is still uncertain.

Exhibit 8 Oil price vs price of palm & soybean oil



Source: World Bank

Regulatory framework is expected to boost demand gradually

At least there are two regulations issued by government of Indonesia in order to spur CPO demand especially in the domestic market. By end of May 2015, it is expected that Indonesia will implement an export levy of USD 50/MT for CPO shipments and USD 35/MT on processed palm oil products. The levies will be used to fund biodiesel subsidies, replanting, research, and develop human resources in the industry. This regulation is likely to support the mandatory biodiesel implementation this year and expectation of higher proportion of biodiesel in the future. This can be a positive catalyst for palm oil price in the long-term as it will spur demand for biodiesel and reduce the supply in the global market.

The above regulation is correlated to the previous regulation on biofuel of which the Indonesian government launched B15 program in April 2015 or earlier than previous schedule of next September. This is to support an increase in the proportion of biofuel that must be added to diesel fuel mix to 15% from previously 10%.

Table 1 Biofuel implementation 2014

Participants	Remarks	Target 2014 (kL) (1)	Target 3Q14 (kL) (2)	Achievement 3Q14 (3)	% Realization (3/1)	% Realization (3/2)
PT Pertamina (Persero)	B10 program for Public Service Obligation (PSO)	1,567,000	1,175,250	852,463	54.4%	72.5%
	B10 program for Non- PSO	959,732	719,799	63,478	6.6%	8.8%
<i>Sub-total</i>		<i>2,526,732</i>	<i>1,895,049</i>	<i>915,941</i>	<i>36.3%</i>	<i>48.3%</i>
Non-Pertamina	Non-Pertamina fuel corporates	607,519	455,639	161,257	26.5%	35.4%
PLN (Persero)	B20 program	742,972	557,229	137,174	18.5%	24.6%
	Own procurement	65,028	48,771	3,822	5.9%	7.8%
<i>Sub-total</i>		<i>808,000</i>	<i>606,000</i>	<i>140,996</i>	<i>17.5%</i>	<i>23.3%</i>
Other	Direct user			23,626		
TOTAL		3,942,251	2,956,688	1,241,820	31.5%	42.0%

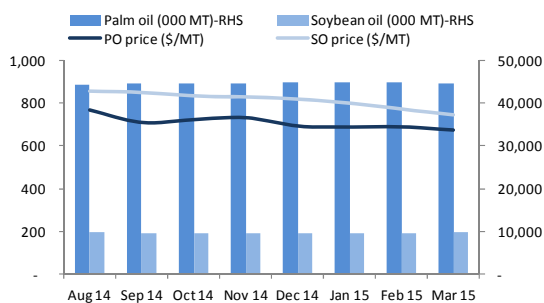
Source: Minister of energy & mineral resources

The program is expected to boost CPO consumption for biodiesel usage to 3.9-4.4 million MT in 2015, much higher than 2014's realization of about 1.5 million MT. Referring to the B15 plan and assuming a realization of 50%, it is estimated that CPO domestic consumption for biodiesel will increase to 1.9-2.2 million MT in 2015 out of total consumption of 10.6-10.9 million MT. However, there is a need of infrastructure improvement to distribute the biodiesel nationally as well as mechanism and control of implementation to ensure the progress of blending target.

To respond to the prolonged pressures on palm oil prices globally, standing at below USD 750/MT since October last year, the government has kept CPO free of export duty up to now. Previously, the Malaysian government had also slashed the export tax to zero percent in order to spur demand in the global market. Furthermore, the Indonesian government also set export benchmark price at lower levels which is expected to boost demand and thus support prices in global market.

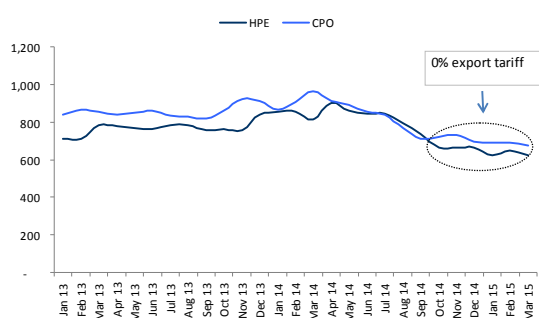
However, six months after the implementation of zero duty and lower benchmark price, the average monthly palm oil export in the global market was relatively stagnant with the highest level of about 44.9 million MT during December 2014-February 2015. It then slipped to around 44.6 million MT in March 2015 or relatively the same as export level in October 2014. Apart from the weak demand, this was also impacted by the increase in soybean export including from EU and the US to about 9.7 million MT in March 2015 from 9.4 million MT in October 2014 due to the crop season. At the same time, China utilized its soybean production to fulfill domestic consumption that could substitute palm oil. In tandem with its declining palm oil import to about 6.1 million MT in March 2015 (vs. 6.3 million MT in January), Chinese palm oil consumption dropped to around 6.0 million MT compared to 6.2 million MT in the same period. Thus, it is predicted that the Indonesian government will maintain zero duty for palm oil export in the rest of the year as the result has so far been minimal.

Exhibit 9a. Palm & Soybean oil



Source: USDA

Exhibit 9b. Export benchmark price (HPE) \$/MT



Source: Minister of Trade & Finance

Summing up

In ICRA Indonesia's opinion, palm oil prices will remain under pressure this year, mainly due to the subdued demand following the global economic slowdown and the sustained supply particularly from the two largest producing countries, Indonesia and Malaysia. The regulation to increase the biofuel usage in the biodiesel fuel mix from CPO is expected to spur palm oil demand domestically. Previously, regulations to support palm oil industry in the form of zero tariffs for export and lower export benchmark price have been implemented and were expected to spur the overall demand for palm oil. Nevertheless, the result has been minimal as reflected in the stagnant export level globally since October 2014. Thus, it is predicted that the government will maintain the zero tariff for palm oil export for the rest of the year. ICRA Indonesia expects palm oil price to remain under pressure and will range between USD 650-700/MT this year taking into account the above factors.

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