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Agri Commodity Markets Research

Positive Palm Readings...

Agri Commodity Markets Research
Food & Agribusiness Research and Advisory

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Palm oil prices continue to appreciate despite the imminent arrival of record-large South American oilseed crops. A closer look reveals that while improved oilseed production will lead to greater vegetable oil supplies, continued strong demand will result in a global vegetable oil deficit of nearly 1 million tonnes in 2009/10. Export availability of alternative vegetable oils is unlikely to increase substantially, meaning the reliance on palm oil exports will remain strong, and while production is forecast to increase, the palm oil market will experience its second consecutive YOY deficit in 2010. There are some conflicting forces at play, but given the tight market conditions, we favour being a buyer of palm oil on any significant price weakness.

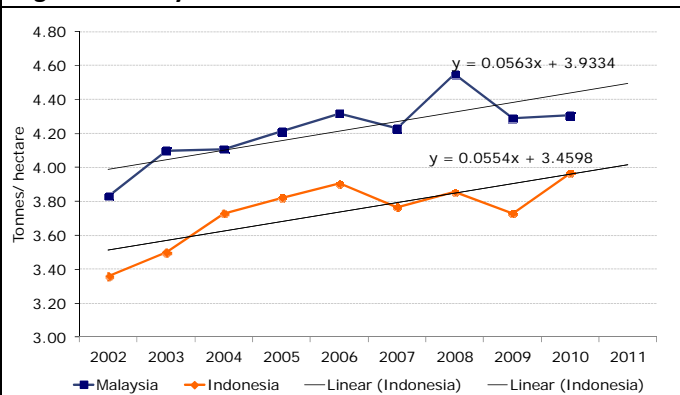
Palm Oil Production Outlook

Following last season's decline, palm oil production in Malaysia is expected to increase this year based on a small anticipated recovery in yields and expanded acreage. Acreage expansion is expected to slow in 2010 due to the Malaysian government's efforts to improve the age structure of plantations by encouraging the replanting of aging plantations, which has reduced the number of mature trees in production.

uncertain. The Malaysian Meteorological Department is currently forecasting the El Niño weather pattern that has been existence since April 2009 to weaken and normal rainfall patterns to develop through until July. An improved rainfall outlook should allow palm fresh fruit bunch (FBB) yields to rebound modestly from last year's levels.

The decline in FFB yields witnessed throughout 2009 was partially mitigated by excellent milling efficiency, which saw the oil extraction rate reach record levels. Rabobank believes it is unlikely that the same efficiency levels will be maintained and expects the oil extraction rate to fall back to more trend-line levels throughout 2010. Based on the assumptions of a slight increase in the FFB yield and a small decline in both the oil extraction rate and acreage growth, we project total 2010 Malaysian palm oil production to reach 18.2 million tonnes, a 3.5% increase from 2009.

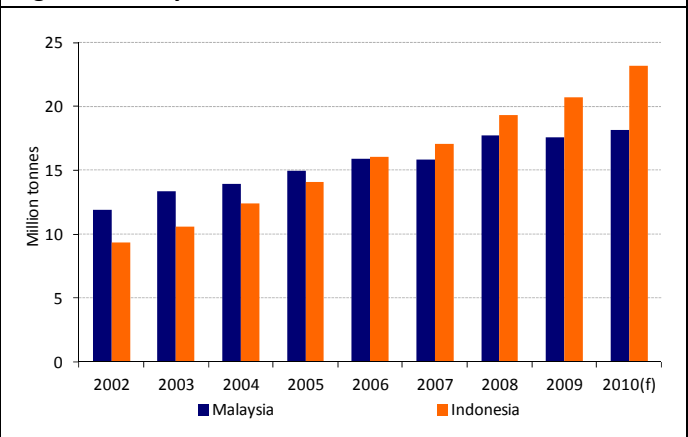
Figure 1: Malaysian and Indonesian Palm Oil Yields



Source: MPOB, GAPKI, IOPRI, Rabobank

Rainfall throughout 2009 was below average in a number of key producing regions, including Sabah and Johor, which account for 30% and 17% of production, respectively. However, the actual impact on forthcoming yields is still

Figure 2: Malaysian and Indonesian Palm Oil Production



Source: MPOB, GAPKI, IOPRI, Rabobank

Production in Indonesia is projected by GAPKI to increase by 2.5 million tonnes from 2009 to 23.2 million tonnes this year. The last time such a significant increase in production occurred was during the peak of the palm oil price rally in 2008. The production increase is likely to come from a combination of acreage expansion and improved yields. Trees planted during the early stages of the price rally in 2006 and early 2007 are now beginning to come online, while yields are forecast to benefit from an improved rainfall outlook due to the weakening El Niño weather pattern. Total production for Malaysia and Indonesia will



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increase by 3.1 million tonnes, up from a 2.3 million tonne increase in 2009.

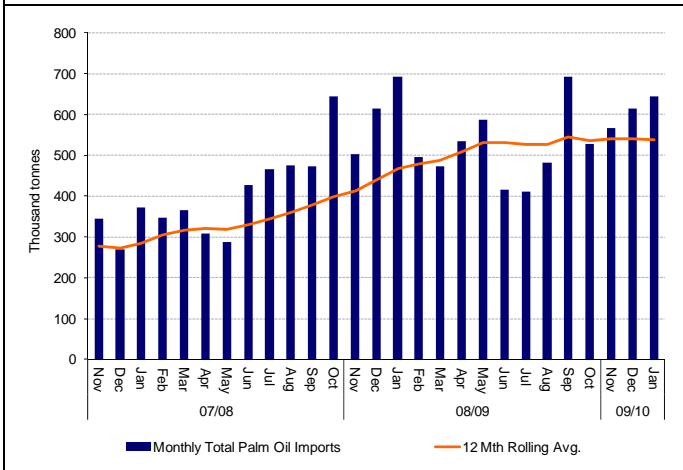
Demand and Imports in Key Export Markets

India

Indian palm oil import growth reached 23.8% in 2009 as a combination of near-zero palm import tariffs, drought-reduced domestic edible oil production and a global shortage of soybean and soy oil supplies drove palm oil import volumes up significantly.

Going into 2010, we expect palm import tariffs to remain at or very close to zero, which when combined with an expected 13% year-on-year (YOY) growth in edible oil consumption, should be supportive for palm oil demand. In addition, Kharif oilseed production was down 15% YOY, and expectations for rapeseed production continue to deteriorate. This, combined with the fact that Indian farmers are unwilling to release on-farm stocks at prices that are workable for the domestic crushing industry, means the outlook for domestic edible oil production is less than favourable.

Figure 3: Indian Palm Oil Imports



Source: ISEA, Rabobank

India's November to January palm oil imports have totalled nearly 2 million tonnes. While this is less than in the corresponding period in 2008/09, there has been a drawdown on domestic palm oil stocks over the period, indicating that the volume of palm oil imports is likely to increase going forward. While import growth is expected to slow to 7.5% from 23.8% in 2009, Rabobank is projecting total 2010 Indian palm oil imports to increase by 480,000 million tonnes, reaching a total of 7 million tonnes.

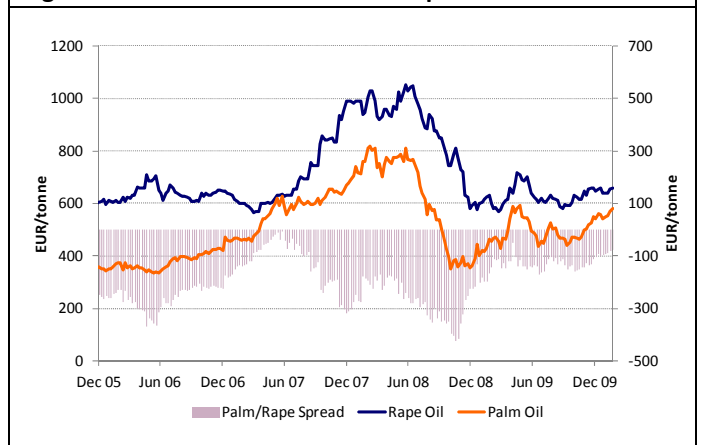
China

We expect Chinese edible oil consumption growth to maintain the 5-year average of 5.5% through 2010. Growth has been relatively stable over this period and, despite recent moves by the Chinese government to raise bank reserve requirements, the current economic outlook indicates that growth in edible oil consumption is unlikely to deteriorate.

Palm oil's share of total domestic edible oil consumption is projected at 26% for 2010, with Chinese palm oil imports expected to reach 6.9 million tonnes, an increase of 450,000 tonnes from 2009. However, risks to Chinese palm oil imports could come in the form of large volumes of soybean imports which are expected to arrive over the coming months.

Already soy product prices in China have come under considerable pressure due to the increased supply arising from the large volumes of soybeans crushed over recent months. This has forced the premium between soy oil and palm oil in Southern China to decline from USD219 to USD80 since December 2009. There is no clear historic trend in relation to the impact on Chinese demand for palm oil when domestic price relativities have moved into a position where soy oil becomes more price competitive. However, if the spread continues to tighten, the trade will begin looking anxiously towards Chinese import reports to see whether a slowdown has occurred.

Figure 4: Rotterdam Palm Oil and Rapeseed Oil Prices



Source: Bloomberg, Rabobank

EU

A large 2009/10 rapeseed crop and positive crushing margins have seen supplies of rapeseed oil in Europe increase substantially, which has put pressure on rapeseed oil prices relative to other vegetable oils. The discount of palm oil to rapeseed oil in Rotterdam has declined to EUR 57



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per tonne from just under EUR 180 per tonne in early November, resulting in increased uptake of rapeseed oil by the biodiesel and food industries. Rabobank expects relatively abundant supplies of rapeseed oil will work to keep this spread tight and to encourage further substitution of rapeseed oil for palm oil, with total EU palm oil consumption growth expected to slow to 6.3% in 2009/10 from 15% in 2008/09. Despite the slowdown, the additional 320,000 tonnes of demand will see import requirements rise from 5.79 million tonnes in 2008/09 to 6.05 million tonnes in 2009/10.

Competition from the Wider Vegetable Oil Complex

Palm oil exports and demand will also be closely linked to the fortunes of alternative vegetable oils and oilseed markets. Following a poor 2008/09 production year, South American soybean production is forecast to rebound substantially in 2009/10 to a record 126.4 million tonnes. Argentina, the dominant global soy product exporter, will see soybean production increase 66% to 53 million tonnes, allowing crushing rates to return to more normal levels and leading to improved soy oil supply. Increased crushing activity in the US and large soybean exports have improved the supply of soy oil, and with supply likely to increase further as the soybeans harvest and crush progresses in South America, total global supply is expected to increase by over 1.6 million tonnes. However, the ability of Argentina and, to a lesser extent, Brazil to significantly increase their exportable surplus is limited by the implementation of recent biodiesel mandates. This means there will be little increase in global soybean exports.

In Argentina, increased soybean supply and improved crush figures are expected to see total soy oil supply increase by 250,000 tonnes to 6.35 million tonnes. However, the Argentine government has introduced a new domestic biodiesel mandate composed of a 5% biodiesel blend for the transport sector and a 20% blend for electricity generation. The mandate is likely to see an additional 865,000 tonnes of biodiesel used for domestic consumption and soy oil is expected to make up the majority of the additional needs. This, combined with an expected larger biodiesel export program, is likely to increase domestic use to 1.91 million tonnes—up from 1.48 in 2008/09—while at the same time limiting Argentina's 2009/10 exports to 4.7 million tonnes, which is actually down 153,000 tonnes on 2008/09.

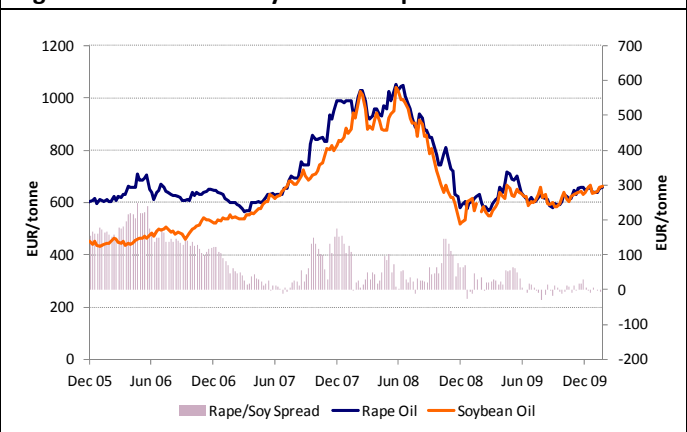
In Brazil, production is forecast to increase slightly, but exports are forecast to be down 18.2% to 1.56 million tonnes, due in part to increased domestic biodiesel consumption. While YOY exports are expected to be down in Argentina and Brazil, low soybean production in 2008/09

has resulted in very low October to January exports, meaning that soybean export flows from these countries will begin to increase considerably in the coming months. In the US, the absence of South American supplies in the October to September period has seen record demand for US soy oil exports, which, when combined with historically low oil yields, has led to a relatively tight US soy oil market. Exports are forecast to reach a record 1.55 million tonnes in 2009/10.

Domestic use in the US is also likely to improve following an Environmental Protection Agency's (EPA) ruling stipulating that biodiesel made from soy oil will meet the 50% greenhouse gas emissions requirement. The result is positive for the US biodiesel industry, as already poor margins have become even worse following the expiration of the USD 1 per gallon blender's credit in December. The EPA's ruling now opens the way for the reestablishment of the biodiesel blender's credit, and although the credit legislation was withdrawn from a bill in early February, most market participants believe that it will be reinstated sometime in the near future. The credit of USD 1 per gallon should help to improve demand, but only if the premium for soy methyl ester relative to US heating oil falls below USD 1 per gallon.

This means total soy oil exports from the 3 major exporters are likely to stagnate at around 7.8 million tonnes. Given the expected increases in total vegetable oil consumption, this could mean considerable pressure being placed on palm oil exports. Fortunately, a large 2008/09 EU rapeseed crop has seen EU rapeseed oil supplies increase, pressuring the spread between rapeseed oil and soy oil prices in the EU. This has resulted in increased uptake of rapeseed oil and relieved some of the pressure on the soy oil export market. Despite this, global ending stocks for soy oil are still forecast to decline to 3.58 million tonnes by 30 September 2010 from 3.67 million the year before.

Figure 5: Rotterdam Soy Oil and Rapeseed Oil Prices



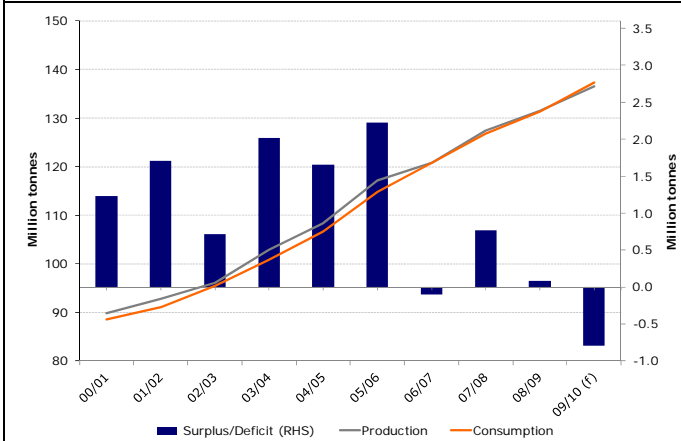
Source: Bloomberg, Rabobank



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Lower cotton seed, ground nut and sunflower oil are likely to partially offset the gains in palm oil and soybean oil production and result in a total vegetable oil production figure of 136.53 million tonnes, an increase of 3.8%, which, when considered against a 4.5% increase in demand to 137.33 million tonnes, will see the global vegetable oil market in deficit throughout 2009/10. Marketing year-end stocks will decline to 14.39 million tonnes from 15.14 million tonnes and see the stocks-to-use ratio decline from 11.5% to 10.5%.

Figure 6: Global Vegetable Oil Production, Consumption and Surplus/Deficit



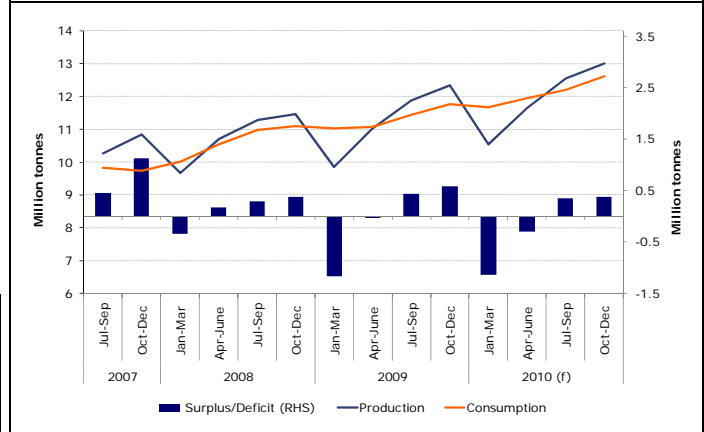
Source: USDA, Oil World, Rabobank

Palm Oil Supply and Demand Balance

With palm oil production in Malaysia and Indonesia forecast to increase by 3.1 million tonnes, Rabobank is forecasting total palm oil production in 2010 to reach 47.73 million tonnes. Production growth in 2010 is forecast to increase to 5.8% from 4.7% in 2009, with Indonesia as the primary source of increased production. Total palm oil consumption is forecast to increase 6.9% to 48.45 million tonnes in 2010 and will outstrip production gains for the second consecutive year.

With demand from the 3 major importers expected to remain strong throughout the remainder of 2010 and supplies of alternative vegetable oils relatively limited, global palm oil exports are forecast to increase 7.7% YOY to 38.15 million tonnes. The increase in export flows will be driven primarily by Indonesia, where, despite the introduction of a 3% export tariff, exports are expected to increase 16% to around 18 million tonnes. In Malaysia, smaller production increases will limit export growth to 834,000 tonnes.

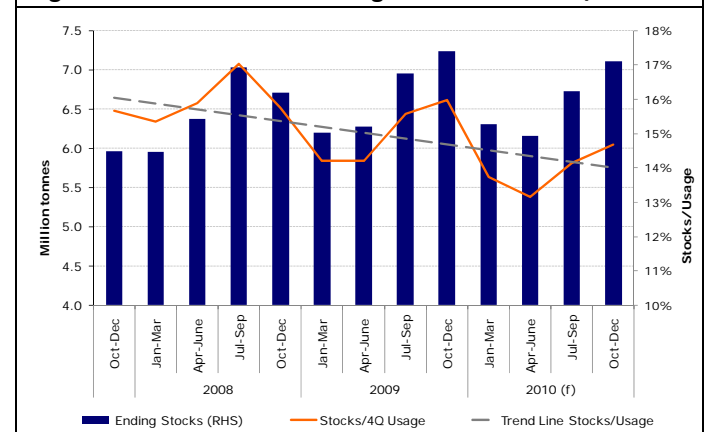
Figure 7: Global Palm Oil Quarterly Production, Consumption and Surplus/Deficit



Source: Oil World, MPOB, IORPI, GAPK, Rabobank

With consumption outstripping production, 30 December 2010 ending stocks are forecast to decline to 7.11 million tonnes from 7.24 million tonnes at the end of 2009. While the actual volume of decline in ending stocks is not substantial, it is important due to the increase in consumption. 2010 ending stocks of 7.11 million tonnes exist at just 14.7% of the previous year's consumption, and while seasonally stocks are likely to reach a low in the April to June quarter, a stocks-to-use ratio of 14.7% is a full 1.3% lower than at the end of Q4 2009.

Figure 8: Global Palm Oil Ending Stocks and Stocks/Use



Source: Oil World, MPOB, IORPI, GAPK, Rabobank

Price Outlook

With the exception of palm oil, the price of the underlying seed source has a major influence on the price of the corresponding oil price. Given the substantial increase in global soybean supplies, we have a bearish view towards



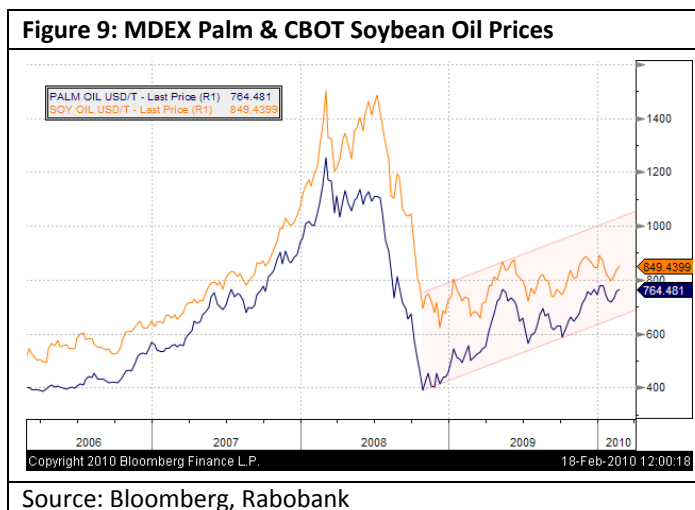
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5 February 2010

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soybean prices (and towards those of most competing oilseeds) throughout 2010. Taking this into consideration, the actual flat price level of soy oil and other oilseed-based vegetable oils is at risk of declining in line with oilseed prices.

However, given the tightness experienced in the vegetable oil market and particularly palm oil throughout the rest of 2010, vegetable oils should remain better supported in relative terms, and the share oil contributes to crushing margins will have to increase given the negative outlook for meal prices.



Therefore, Rabobank sees limited downside for palm oil and the wider vegetable oil complex throughout 2010.

Vegetable oil prices remain in a demand-driven uptrend and we believe any significant retracement will be met by active buying as importers and end users look to increase coverage. We would therefore be a scale-down buyer of palm oil.



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