First Half Year at Glance

Palm oil prices experienced a rally during the first half (H1) of 2021, with the average monthly Malaysian delivered Crude Palm Oil (CPO) price ranging between a high of RM 4572/ton in May 2021 and a low of RM 3749/ton in January 2021. The Bursa Malaysia Derivatives Exchange's Crude Palm Oil Futures (FCPO, Figure 1) third-month benchmark price also experienced a rally during this period, fluctuating between RM 3160-4525/ton, trending lower after hitting a record high of RM 4525/ton on 12 May 2021.

Low palm oil ending stocks in Indonesia and Malaysia kept prices firm. Indonesian Palm Oil Association (GAPKI) data showed that Indonesia's inventories were at 2.88 million tons for May 2021, down 18% year-on-year. While in Malaysia, according to Malaysian Palm Oil Board (MPOB), the inventories were at 1.61 million tons for June 2021, down 15% year-on-year (Figure 2). Supply disruptions and rebounding demand led by recovering economic activities from the second half (H2) of 2020 have kept inventories at below average levels.

Figure 1: The Bursa Malaysia Derivatives Exchange's Crude Palm Oil Futures (FCPO) third month benchmark contract price during H1 2021 (Source: Refinitiv)
There has been a halt in palm oil output growth in the last 3 years (Figure 3) mainly due to wet weather conditions, remaining effects of prolonged drought in Q3 2019, lower fertilizer applications over the past few years and labour shortages (primarily in Malaysia). MPOB data showed that CPO production in Malaysia in the H1 of 2021 totalled 8.36 million tons, down 7.6% compared to the same period in 2020. In contrast, Indonesia CPO production during the first 5 months of 2021 totalled 17.91 million tons, edging up by 3.2% year-on-year, indicating a faster production recovery.
Year-to-date Malaysia palm oil exports were relatively subdued (Figure 4), totalling 7.07 million tons for H1 2021, down 9.3% year-on-year. In contrast, Indonesia palm oil exports in the first 5 months of the year totalled 13.67 million tons, up 7.4% year-on-year.

Figure 4: Malaysia and Indonesia palm oil exports (source: MPOB, GAPKI)
Second Half Year:

Production Outlook

Indonesia CPO production for the whole of 2021 is forecasted to be higher by 1-3 million tons versus 2020 at 47-50 million tons, while Malaysia production is expected to be around 18.7-19.3 million tons. The lagged impacts of prolonged drought in Q3 2019 (Figure 5) and lower fertilizer applications over past years have capped the upside, but palm oil production in both countries will see seasonal recovery in H2 2021. Indonesia is poised to have a more robust output recovery relatively to Malaysia due to good estate management and no halt of operations as well as labour shortage. Malaysian palm oil industry was short of approximately 31,000 harvesters, prompting significant crop losses. Progress of recruiting locals for the job and bringing back foreign workers is slow in the face of the prevailing COVID-19 situation.

In terms of the weather outlook, the Niño 3.4 region has trended warmer from a La Niña state towards a neutral negative ENSO state in recent weeks, which would bring drier-than-normal weather conditions across most palm-growing areas in Malaysia and Indonesia during July-August (Figure 6) if the trend continues. Lack of heavy rains will benefit harvest activities, boosting output during this period. September-November could feature wetter than normal weather conditions, which will largely favour palm growth in the region.
Figure 6: Southeast Asia composite precipitation anomalies (mm) from the July-August statistical model/analog mean (source: ESRL/NCEP, Refinitiv Weather Research)
Demand Outlook

The demand outlook for H2 is pointing more towards upside, with the reopening of the HORECA (Hotels, restaurants and café) sector amid large-scale COVID-19 vaccination rollouts worldwide boosting higher demand in food and non-food (e.g. oleochemicals, biofuels) industries. Demand is also underpinned by palm oil’s steep discounts to soybean oil, which widened to USD$480/ton by the end of June (Figure 7), making palm oil more attractive versus rival edible oils. The recent price correction in June has also attracted bargain buying.

Palm oil inventories in India and China, the two largest consuming countries, remain low (Figure 8), encouraging replenishing activities. Stocks in China for June were estimated at 0.34 million tons, down 29% year-on-year, while inventories in India were at 0.32 million tons, down 4% year-on-year. Also, warmer weather during summer is conducive to blending, potentially boosting higher domestic consumption, further depleting inventories and encouraging demand.
Both key producing and consuming countries have revamped tariff structures in favour of boosting demand in H2.

Indonesia adjusted export levies for July, lowering the ceiling rate for crude palm oil levies to USD$175/ton from USD$255/ton. The export levy starts when CPO prices hit USD$ 750/ton, with an USD$20 increase for every USD$50 rise in CPO. Palm oil export duties were also slashed to USD$116/ton for July, versus June’s USD$183/ton, in response to falling CPO reference prices. The new palm oil levy is likely to lift exporters’ profit margin and prompt selling abroad. Supported by the levies, the implementation of the B30 mandate in Indonesia remains an underpinning to sustain considerable domestic consumption since demand for the fuel has been evenly spread in 2021, according to recent report of Indonesia’s state-owned oil company. The revision of export levies bears no impact on financial-backing the on-going national replanting programs targeting 180,000 hectares in H2.

India, the world’s largest importer, lowered CPO import tariffs to 10% from 15% for three months, effective June 30, making the effective rate, including other tariffs, 30.25% versus the previous rate of 35.75%. Moreover, India removed refined, bleached and deodorized (RBD) palm oil and RBD palm olein from the list of restricted items for a period of 6 months until December 31, prompting palm oil imports more appealing compared to rival edible oils. Buyers could take this opportunity to ramp up palm oil imports to meet high festive demand.

However, there are several downside risks for demand. Palm oil imports by key destinations, such as India, slumped earlier this year due to a resurgence of COVID-19 cases in the country. The continued impact of COVID-19 will influence global consumption in food and non-food sectors and determine the pace of demand recovery in H2.

Also, bumper oilseed supplies in the months ahead, and the EU’s policies will negatively impact the market. Renewable energy directive (RED II) is poised to cap palm oil as feedstock for biodiesel in the mid-to-long run. The Belgian government had notified the EU of a draft national decree that is poised to exclude palm oil-based biodiesel from its market from 2022 onwards. Moreover, the EU’s new food safety standards on 3-monochloropropane diol (3-MCPD) and glycidyl fatty acid esters (GE), contaminants found in refined palm oil product, are also expected to weigh on imports.
Price Outlook

Palm oil prices experienced a prolonged rally since last year, fueled by tight supplies and demand recovery. However, the rally tapered off in June (Figure 9). Worries about lacklustre demand and production recovery going forward have depressed palm oil prices recently. Erosions in external vegetable oil markets, such as the Chicago Board of Trade and the Chinese Dalian Commodity Exchange, have also weighed on sentiment. As Malaysia and Indonesia have entered the peak palm oil production season, prices could be pressured by rising inventories. We believe that palm oil prices will stay elevated, supported by low inventory levels at both origins and destinations, but will remain volatile throughout H2, affected by other market drivers.

Figure 9: Weekly FCPO (Source: Refinitiv), uptrend line support was broken. Next supports at RM 3150-3250, resistances at RM 3800-4000-4200.
Caveats

a) Bigger global oilseed production is on the way

Palm oil production is picking up and prices could face pressure if production increases significantly in the coming months. As Indonesia has a faster pace of recovery, H2 production will be dependent to a large extent on weather factor and stability of estate management in supply performance. Current favourable levy structure is also expected to provide space for companies to increase production capacity which will lend support to the enhancement of downstream industry, R&D, scholarship and replanting programs.

The pace of production recovery in Malaysia will depend on how soon the industry can get adequate foreign workers and the yield recovery from 2019's dryness and lower fertilizer applications from previous years.

The United States Department of Agriculture (USDA) also indicates more global oilseed supplies going forward, with global soybean production for 2021/22 higher by 21.7 million tons from 2020/21 levels to 385 million tons. The USDA raised global soybean ending stock estimates for 2021/22 by 3.0 million tons from 2020/21 levels to 94.5 million tons, on the back of higher beginning stocks for the U.S. and Brazil. Refinitiv Agriculture Research pegged global soybean production and global soybean ending stocks for 2021/22 at 385 million tons and 90 million tons, respectively (estimates as of June).

The USDA raised global rapeseed production by 5.1 million tons to 74.1 million tons for 2021/22. Global sunflower seed production was also raised by 7.3 million tons to 57.0 million tons in the coming season. Bumper sunflower crop from the Black Sea region will be entering the market to compete for a share in the months ahead.

b) Uncertainties in external policies

U.S. government policy on biofuel remains uncertain. Soybean oil prices tumbled after the news that the U.S. government considering providing oil refiners relief from biofuel blending mandate, following a Supreme Court ruling that exempt small oil refiners from biofuel blending requirements. This will limit biofuel production, reducing demand for soybean oil. Talk that the Environmental Protection Agency is relooking at biofuel blending requirements adds to the uncertainty, with any unfavourable adjustments to biodiesel waivers likely to trigger another sell-off.

In addition, China's plans to strengthen commodity price control domestically, reflected by its move to auction imported corn and soybean oil to cool domestic prices, is also view as bearish for the market.
Supporting drivers

a) Unfavourable weather conditions in the U.S.

Weather concerns in the U.S. will continue to impact the oilseed market – support has been drawn from a dry spell and heatwave in parts of the Midwest. The growth of U.S. soybeans in this season is anticipated to be not as good as that of the same period last year, supporting downside for output. However, it is still early in the growing season, and weather conditions in July/August will be critical to soybean yields. The weather outlook suggests that July’s weather will continue to feature hot and dry weather conditions (Figure 10) across U.S. crop growing areas, though the worst dryness may have passed, according to the Refinitiv Weather Research team.

Figure 10: U.S. forecast precipitation/temperature anomalies (mm/°F) for July
(source: ESRL/NCEP, Refinitiv Weather Research)
b) POGO (Palm oil and Gas oil) spread is narrowing

Crude oil futures have been trending higher and hitting above US$75/barrel, the highest levels since 2019, supported by recovering demand amid large-scale COVID-19 vaccination rollouts, lifting gas oil prices to around $80/barrel. The rising gas oil prices amid weakening palm oil prices have narrowed the price spread between the Palm Oil and Gas Oil (POGO, Figure 11) to US$250/ton, from the previous peak of around US$600/ton (May 2021). Narrowing POGO spread means better blending margins and less subsidy is needed to produce palm-based biodiesel, potentially improving consumption prospects.
Conclusion

After a prolonged rally since last year, prices have been beginning to moderate but will stay elevated. The historical peak of RM 4525/ton in five weeks (12 May-18 June), despite the recent bearish benchmark of crude palm oil futures (FCPO) of RM 3262/ton, shall keep the market optimistic. Year-to-date average prices are de facto higher than an expected average of RM 2600-2650/ton as indicated in the first CPOPC Supply and Demand Outlook Report 2021.

The industry holds mixed views on the CPO price trend, with the Malaysia Palm Oil Council (MPOC) forecasting prices to range between RM 3500-3800/ton in the coming three months, supported by rising export prospects while output is expected to increase marginally. Reuters technical analysis suggests that FCPO in Q3 may bounce to RM 3746-3844/ton, before dropping towards RM 2927-3232/ton levels. Some industry players also expect palm oil prices to soften further in H2 after registering an all-time high CPO price in May.

Price volatility will stay in H2, however increased enabling-environments in producing countries, encouraging demand especially from China and India compounded by several supporting drivers in the near/mid-term, shall spark-off positive sentiment. Rising gas oil prices are supportive of the palm oil-based biodiesel market as Indonesia is progressing towards its output target of 9.2 million kilolitres, a target set for the B30 mandate this year. Improved global demand persists amid mass vaccination rollouts, on the back of a steep discount to rival vegetable oils, low inventories in key consuming countries and favourable tariff structures. The US will be a factor to consider due to unfavourable weather and biofuels policy that may deteriorate demand and output growth of soybean oil, giving palm oil a likely advantage for the H2.
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