

Poor weather conditions benefit prices

Thursday, March 17, 2016

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- Palm oil futures for June delivery rose to its highest intraday level of MYR2,654/MT since April 2014, as the extreme heat threatens palm production and harvest efforts.
- Statistically, the Oceanic Nino Index (ONI) had indicated that the current El Nino phenomenon is as severe as the one seen in 1997/8, a period when palm oil surged 133% to MYR2,600/MT then.
- In the light of healthy palm oil export prints in both Malaysia and Indonesia, as well as accounting for upside risk for demand to pick up given the Ramadan in June, palm oil as a commodity would likely be scarcer than before.

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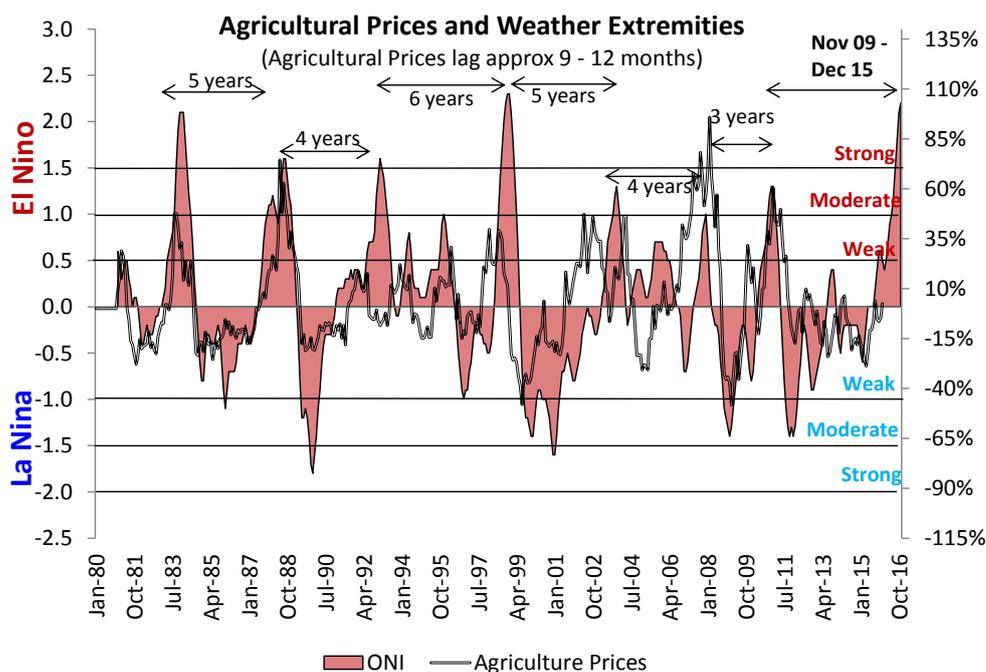
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Back to the drawing board

Much of the outlook for palm oil prices is largely dependent on weather conditions, at least at this juncture. Back in late 2015 when El Nino is a recognised certainty, palm prices started to rally as market-watchers price in poor harvest conditions, despite some mediocre palm oil import demand then. The message the market was likely indicating, was that the harsh weathers, should 1997/8 history be of reference, is a strong indicator for palm oil prices to rally substantially. What the markets had not truly expected however, was that the correctly predicted El Nino phenomenon seen in late 2015 had been unexpectedly prolonged into the first three months of 2016. And even so, there is no telling if Mother Nature would relent anytime soon.



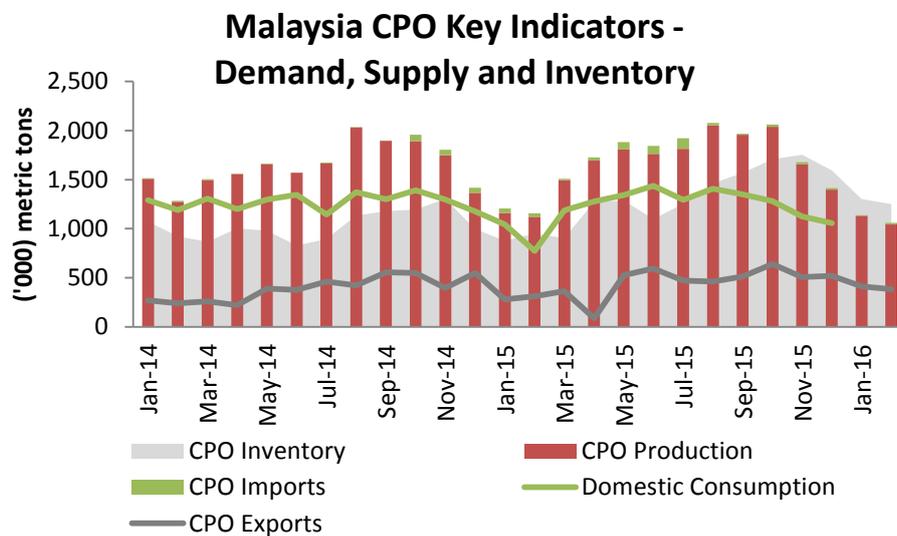
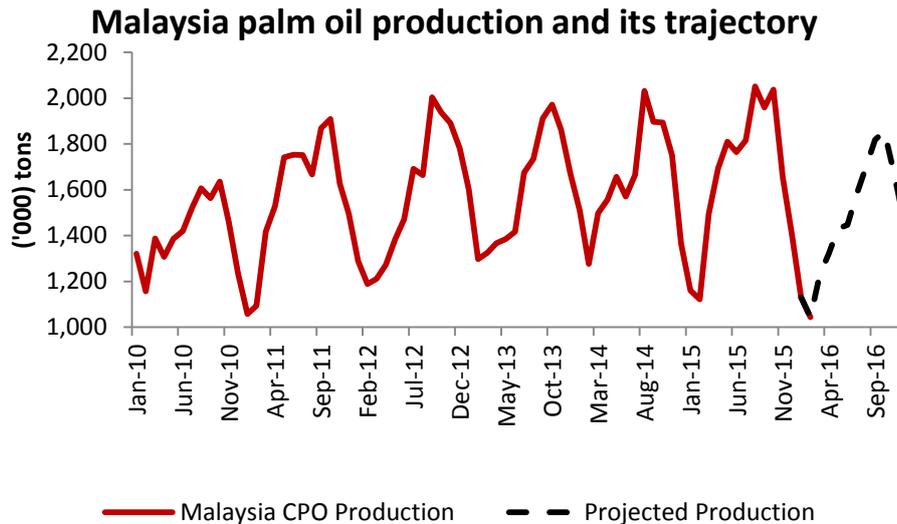
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Source: National Oceanic and Atmospheric Administration, OCBC Bank

As if at the beck and call of Mother Nature, the poor weather conditions have now resulted in dearer agricultural prices, including palm oil, sugar, rubber, and rice – commodities that are largely grown in Asia. With new data in the ONI index, an indicator that specify the severity of the El Nino phenomenon, the current El Nino episode is now as severe as the one seen back in 1997/8, and with it, a stark reminder that palm prices had rallied more than two-folds as the drought threatened harvests and depleted inventories. Still, though palm oil inventories, specifically in Malaysia, are above its 5-year average at 1.25 million metric tons as of February 2016, there is a real risk of inventories falling significantly especially if production falls further amid stronger crude and processed palm oil export prints in Malaysia and Indonesia respectively.

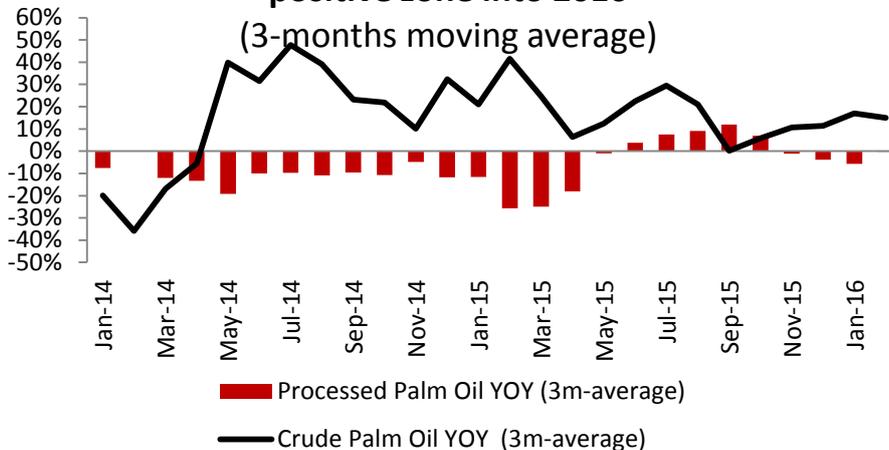


Source: MPOB, Bloomberg, OCBC Bank

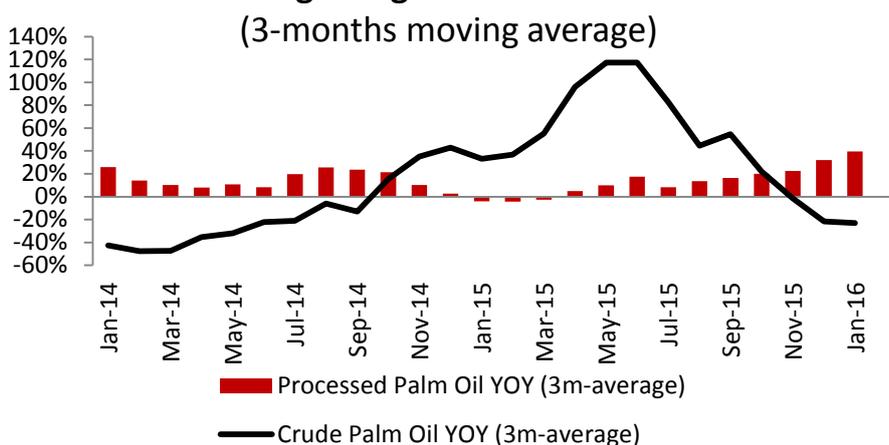
Even so, as the world grapple with the harsh weather conditions and bleak agricultural production levels into the near future, the sustained healthy palm oil demand into the first two months of 2016 has been giving markets another reason to push prices higher. Statistically, crude palm oil exports in Malaysia have been growing at double digits since the start of the year, while processed palm oil exports turned positive after its three consecutive months of contraction. Importantly as well, though Indonesia's crude oil exports continued to fall, it has decelerated considerably, while its processed palm oil arm is flourishing at double-digit growth for the last six months. Palm oil exports into the first half of this year is

likely to expand further even, as we approach Ramadan in June, a period when palm oil consumption picks up seasonally.

Malaysian crude palm oil exports remained in positive zone into 2016



Indonesia's processed palm oil exports is gaining momentum



Source: Bloomberg, OCBC Bank

The mix of demand and supply

Sometimes, it is but a simple observation of demand and supply conditions. Palm oil supplies into the first half of the year is likely to fall further as the harsh weathers appear prolonged. In the same vein, palm oil demand has been healthy, and should continue to point north given seasonal factors. Accounting these factors, palm oil prices are likely to point higher into 1H16. As such, we upgrade our palm oil price outlook to MYR2,800/MT at year-end, from a previous estimate of MYR2,650/MT.

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