

16/09/1998

Living on the edge

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THE market consolidated early in the month with a stable base at around RM2450/MT, aided by a buoyant physical crude market and a rather weak ringgit at around 4.1600 to the US dollar. Activity, however, was listless as interest in palm products lagged, apart from expectations of further Indian demand.

Emerge it did as State Trading Corporation (STC) bought about 78,000 MT of products in a single tender. But prices hardly reacted as the trade was already well covered. Instead, prices dipped on heavy liquidation and only stabilised at the low RM2400/MT levels as the physical crude market was not pressured as much.

From then on prices rallied, initially on friendly end-August Porla figures which put production at 771,980 MT (+10.1%, slightly above estimate) and stocks at 742,218 MT (+6.88%, within estimate despite the good output).

Heavy prompt/spot trade covering powered prices back to RM2460/MT levels, topping off at RM2491/MT ahead of the National Day holidays.

On return, the news that the Mahathir administration was implementing several dramatic financial policies was a bombshell. Foreign-based ringgit was to be repatriated back into Malaysia by Oct 1, and can only be traded onshore after that. The ringgit strengthened to 3.9500 overnight and palm prices ended limit down at RM2399/MT. The following day, the ringgit was pegged to the US dollar at 3.8000 and palm prices collapsed to a low of RM2250/MT on massive liquidation before recovering to close at RM2276/MT for the day.

Prices muscled back in two days on massive products covering in such an uncertain scenario. Reports of STC's interest in acquiring about 50,000 MT of palm products and talk of a possible export duty on Malaysian palm products spurred further trade covering and prices closed high at RM2394/MT.

With the ringgit pegged, the currency volatility in palm trading appears to have been eliminated. Solely on palm fundamentals, the scenario appears friendly.

With Spot FOB RBD Olein stable above US\$710/MT, it appears unlikely that crude prices will trade below RM2360/MT (third month basis). Therefore, we will assume that the ringgit appreciation to 3.8000 has been fully factored in at the low of RM2250/MT and that strong palm fundamentals are responsible for the current run-up. Spot RBD Olein premiums over crude degummed soyoil have maintained position due to some inelasticity of demand and since the increases in output have not been able to meet demand, palm product prices have been well supported.

Demand has been excellent in Aug '98, estimated at about 900,000 MT. India continues to be the major buyer at about 230,000 MT in bulk. Pakistan and China's imports have improved, standing at about 120,000 MT and 105,000 MT, respectively. The trade perceives that the STC still needs to buy about 50,000-80,000 MT of palm products ahead of the Deepavali festivities, especially so with the current case of mustard oil poisoning. Muslim consumers, notably Pakistan, are also expected to increase intake in the next few months ahead of an early Ramadan in mid-Dec '98. Chinese interest will probably increase too because of the recent flood damage to their rapeseed crop.

As for supply, production has been, and still is, good with Aug '98

output estimated at 9% higher at 840,000 MT. East Malaysian output is strong at 12-15% higher while West Malaysian performance is slowing at 6-8% higher. The perception is that production will peak in Sept/Oct '98 and the rate of tapering off in the last quarter will be crucial.

Indonesia still appears unlikely to export palm, with current high domestic prices of about Rp5200/kg and Ramadan coming. This is likely to continue into the first quarter of 1999, the low production period. As such, this displaced demand will still be sourced from Malaysia.

In this scenario, palm stocks will be tight with end-Aug '98 stocks drawing down to about 680,000 MT. Assuming that demand is maintained until year-end and that stocks peak in Oct '98 at a tight 850,000 MT, the year-end carryover stocks will be critical should there be a sharp decline in Nov/Dec '98.

Currently, the bullishness is somewhat checked by comparatively low soft oil prices due to the weather discounts in the US soyoil prices which have been largely factored in. However, if there is a quirk in the weather in Oct/Nov '98, either affecting the 'expected bumper US soybean crop' or the Indian winter oilseeds crop, all hell will break loose.

Therefore, we are friendly to bullish in palm until March 1999 given the inelasticity in demand and the critical supply situation. Scale down buying from RM2360/MT.

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