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The palm oil crisis triggered by Indonesia

Most commodities have seen their supplies materially disrupted since the Ukraine war started two months ago, possibly creating food shortages in certain parts of the world that were highly dependent on Ukrainian wheat and sunflower oil. The recently imposed ban on palm oil exports by the Indonesian government will likely exacerbate the situation even further.



On 22nd April, the Indonesian government caught the world off guard by [announcing](#) a ban on cooking oil raw materials and cooking oil exports to ensure domestic availability, an act similar to the country's previous [ban on coal export](#) earlier this year. There was a short relief when the country's chief economic minister clarified that the ban would exclude crude oil, but it did not last as the government made a dramatic U-turn the following day by contradicting its economic minister and by confirming that the scope of the export ban will indeed include crude and refined cooking oil, leaving markets in shock over the latest development. The focus is crude palm oil, which Indonesia is the largest producer of.

Crude palm oil price went through a wild roller-coaster as the Indonesian government was doing its 360 degrees turn. At MYR7690 per ton, the price of crude palm oil has increased by 49% since the start of the year.

[Crude palm oil futures contracts price on Bursa Malaysia \(MYR/ton\)](#)



Source: Bloomberg – May 2022

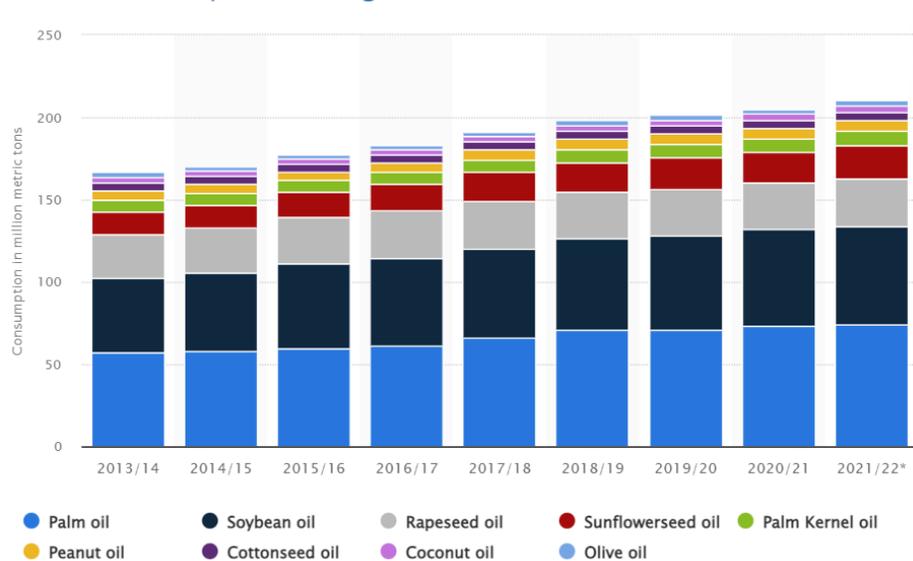
Palm oil is a common ingredient found in nearly 50% of all packaged products in supermarkets ranging from cooked food, frozen food, cosmetics, toothpaste to countless categories of household items, making it an invisible yet critical commodity the world cannot live without. It is also used in animal feed and as a biofuel in many parts of the world. Due to its low cost, palm oil accounts for about 40% of the world's edible oil consumption, and this figure gets even higher in developing countries.

On the supply side, Indonesia dominates the palm oil market as the country controls 60% of the global production of 73 million metric tons. Indonesia exported around 27 million tons of crude palm oil in 2021. The palm oil sector is the archipelago's top export earner, reaping in \$17.9bn last year. Its largest export markets were India (\$3.05bn), China (\$2.47bn), Pakistan (\$1.62bn) and Spain (\$854m) in 2020. By comparison, Malaysia which is the world's second largest palm oil producer exported 18 million tons in 2021. However, Malaysia is unlikely to fill the supply gap created by the ban anytime soon due to its limited crop size and labour availability issues.

The export ban prompted a perfect storm for the already-fragile global food supply chain. Before the ban, palm oil prices were already under upward pressure after Russia's invasion

of Ukraine as the market struggled to find alternatives to shipments of sunflower oil stuck in Black Sea ports. To make things worse, supplies of soya bean, rapeseed and canola were reduced significantly due to severe droughts in South America and Canada. With both the demand and prices of palm oil skyrocketing to an unprecedented level in a matter of months, the Indonesian government eventually decided to prioritise its domestic consumption and forgo the potential gains in the international market.

Figure 1. Global consumption of vegetable oils



Source: Statista – April 2022

Globally, the ban on exports of Indonesian crude palm oil will likely further push up food prices, which are already at an all-time high. Unfortunately, developing countries may feel the pinch even more as food costs account for a higher share of their citizens' expenses. India would likely experience the worst impact as it is the largest importer of palm oil in the world, with food representing as much as 35% of total household expenditures.

With the Indonesian government's current guidance of keeping the export ban in place until bulk cooking oil prices drop to IDR14,000 (USD0.97) per litre which is approximately 20% to 25% lower than the current price on international markets, [industry experts](#) expect such ban to be temporary.



As palm oil is perishable and as the country is running out of both processing and storage capacities domestically, crude palm oil producers will soon be struggling to find buyers for their inventory. It is hoped that the ban on exports won't last too long as a result.

The palm oil sector has long been controversial in the eyes of environmentalists and ESG investors. In tropical countries where palm oil is produced, it has been a major driver of deforestation of some of the world's most biodiverse forests, destroying the habitat of already endangered species including orang utans. Despite being officially illegal, deforestation is widely used to replace older palm trees by younger ones to achieve higher production yields. Burning large plantations creates massive smoke clouds that engulf every year large parts of Indonesia, Malaysia and Singapore, bringing along their share of health hazards.

Forced and child labour has also long been a dark stain on the palm oil supply chain. Even with the supposedly "certified sustainable" palm oil products which is a label created by Roundtable on Sustainable Palm Oil (RSPO) in early 2000, issues with deforestation still persist as plantation owners look for ways to expand their production. These controversies drove ESG-conscious investors globally to turn away from the sector by placing it under the negative screening list. Pressure from investors and from the broader international community have led palm oil producers and producing countries to take a more cautious view on production expansion plans, which in turn resulted in a slight decline in production volumes over the past few years.

To some extent, this origin of this palm oil crisis resembles the Indonesian ban on coal exports a few months ago. These two events serve as a reminder of the systemic vulnerability that is present across the global food and energy supply chains, compounded by the Ukrainian war and an unprecedented supply chain snarl.

Perhaps it is time to ask ourselves whether we have been turning away from “unsustainable” products such as palm oil and thermal coal too quickly without first securing alternative solutions.

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