

Analyst's Insight: Thinking lean for 2016

Cereals is done and dusted for another year and the event, for many, would have informed thinking for the 2016 harvest. The two main questions that have probably come to mind are:

1. What crops am I going to grow?
2. What varieties am I going to grow?

These are of course very legitimate questions to ask to ensure that the farm has the most suitable rotation and is using the most appropriate varieties.

However, before committing to production it is really important to be aware of the market signals and what this means for profitability prospects for the 2016 crop. As the chart below shows, pre-planting prices for November 2016 wheat and oilseed rape (OSR) in June are at multi-year lows. For many businesses, this could well mean that seed is being bought and planted at a time when prices are below the costs of production. Of course prices can always rise post-planting but relying on this, as well as kind weather to grow the crop, simply acts to multiply the risk that the business is taking.

As a result, farmers will be keeping a close eye on costs and making operations as lean as possible. With

this in mind though, blindly trying to reduce costs rather than control them is a dangerous arena as it risks removing some key value adding steps in crop production. As an extreme example, a farmer might decide to slash fertiliser application in response to low prices, but then crop yields tumble as a result. **Cost control and indeed 'lean thinking', are key in managing periods of low prices.**

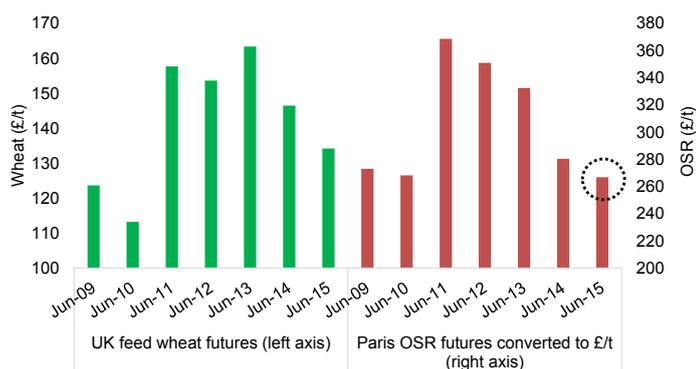
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However, the reality is that even with pre-planting prices below *true* costs of production, crops will probably still be planted. This largely comes down to the fact that production is still likely to turn a cash margin, which can be used to service the 'fixed' cost base and would probably keep the business in a better position than if crops weren't planted.

This general response to low prices assumes that fixed costs are not something you can just switch-off – perhaps every business should aspire to challenge this assumption and aim to make production as market responsive as possible. [We used OSR in an example of this in a recent Prospects article.](#)

Jack Watts

Pre-planting feed wheat and OSR futures prices* in the month of June prior to planting



* Prices are based on the November contract for the following season

Source: AHDB

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A new variety of OSR for harvest 2016: Virtual OSR?

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2014 Wheat Pricing Strategies update – the risk of failing to act

Over the life of the 2014 example pricing strategies, wheat prices fell by £50/t. This final update examines the ability of each strategy to manage the fall, while being able to take advantage of any short-term market appreciation.

Margins plummet but policy continues to provide a prop for biodiesel

Lower crude oil prices relative to vegetable oil prices have hurt biodiesel production margins around the globe. However, while market conditions have been unfavourable, government intervention continues to exert an important influence on the industry's fortunes.

Australian crop production faces east – west split in 2015

The El Niño weather pattern is of some concern for producers in eastern Australia.

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Introduction - what drives farmers' decisions to plant?

Profit should be a clear motivation to make a planting decision. However, when prices are low and 'true' profit non-existent, crops generally still get planted. The first piece of rationale behind this is fairly logical. **The crop in question is still likely to be producing a cash margin** that can then be used to 'service' the fixed costs, which by their very name are regarded as 'fixed' – or are they? We'll explore this later.

The second justification for planting when prices are low is often: **"If I don't plant it, the price is bound to go up and I'll kick myself if I miss out"**. This essentially makes the farmer no different to a financial speculator operating in commodity markets: one is speculating by buying futures contracts, the other by producing a physical commodity – both need the price to rise to make a profit.

The two bits of reasoning above, underpin what is a key market failure element i.e. the inability of the primary producer to respond to market signals. In this article, we will begin to look at how these bits of rationale could be managed to allow the farmer to better respond to market signals. To illustrate this we will look at OSR for harvest 2016 for which planting decisions are now being made, with a backdrop of low prices.

The outlook is not bright for profit potential

Using figures from the Agricultural Budgeting and Costings (ABC) handbook (May 2015) and current forward prices, a 2016 gross margin of £454/ha is forecast for winter OSR. This assumes achievement of an average yield of 3.65t/ha, with variable costs (seed, fertiliser, crop protection and sundries) of £458/t. This also supposes Nov-16 ex-farm prices of £250/t, calculated using Paris rapeseed futures as a basis. Going a step further and assessing the fixed costs for the business gives a better indication of profit, after all costs attributed to growing the crop have been accounted for.

Assuming a medium sized cereal farm, the fixed costs (labour, machinery and power, rent and interest and other costs) to grow winter OSR have been estimated at £835/ha by the ABC. Please note that these costs are based on data collected from the Farm Business Survey and are used as a guide only, in reality, there can be wide variation in actual fixed costs between

similar enterprises based on their own circumstances. Farmers are urged to have a firm grasp of their entire cost profile, both variable and fixed – [speak to your Regional Manager about how AHDB can help with this.](#)

Figure 1 below shows the possibilities of net margins (profit per hectare) that could be achieved with varying prices (vertical axis), against a range of yields (horizontal axis).

Figure 1 Net margin sensitivity analysis

		Yield (t/ha)								
		2.99	3.16	3.32	3.49	3.65	3.82	3.98	4.15	4.31
Ex-farm price (£/t)	190	-725	-694	-662	-631	-600	-568	-537	-505	-474
	205	-680	-646	-612	-579	-545	-511	-477	-443	-409
	220	-635	-599	-563	-526	-490	-454	-417	-381	-345
	235	-590	-552	-513	-474	-435	-396	-358	-319	-280
	250	-546	-504	-463	-422	-381	-339	-298	-257	-216
	265	-501	-457	-413	-369	-326	-282	-238	-195	-151
	280	-456	-410	-363	-317	-271	-225	-179	-132	-86
	295	-411	-362	-314	-265	-216	-168	-119	-70	-22
	310	-366	-315	-264	-213	-162	-110	-59	-8	43

N.B.: Maximum and minimum yields have been calculated by assessing how much historical UK OSR yields have varied around the previous 5-year average. Source: The Agricultural Budgeting and Costing Book (80th edition), Defra, AHDB

Using the costs described above, **Figure 1 doesn't paint a very positive picture for the rapeseed crop for harvest 2016, with the current projection suggesting a loss of £381/ha.** There is only one possibility that would award a profit, requiring a yield of 4.31t/ha or more with a price of at least £310/t. To put this in context, the maximum annual average yield for OSR recorded in the UK was 3.9t/ha in 2011. This suggests that for many farmers, OSR for the 2016 harvest will only be profitable if prices rise and yields improve much more than the current values.

Deciding not to plant

With poor profitability prospects, many might well be considering a reduction in the 2016 OSR area. So what to do with the land. Grow a different crop or leave it fallow? In this example we'll follow the 'leaving it fallow' option as an extreme.

By deciding not to plant OSR, associated variable costs would be eliminated. That is the easy bit. The difficult bit is identifying just how 'switch-off-able' the fixed costs are. To an arable business battling with low prices, a firm **understanding of how variable the fixed costs are is highly valuable information.**

To demonstrate two different levels of fixed cost 'switch-off-ability', we will use two scenarios below. In this example we assume rent and finance not to be 'switch-off-able', but this could well vary from business to business.

A new variety of OSR for harvest 2016: Virtual OSR?

Scenario 1 – 20% of non-rent and finance fixed costs ‘switched off’, total fixed costs = £691/t

Scenario 2 – 80% of non-rent and finance fixed costs ‘switched off’, total fixed costs = £259/t

How ‘switch-off-able’ are your fixed costs?

What if the price rises?

A subsequent price rise after making the decision not to plant would represent a lost opportunity and as discussed earlier, could well be the rationale for planting when prices are low. By deciding not to plant and buying a call option essentially puts the farmer in the same market position had they decided to plant, with the benefits of:

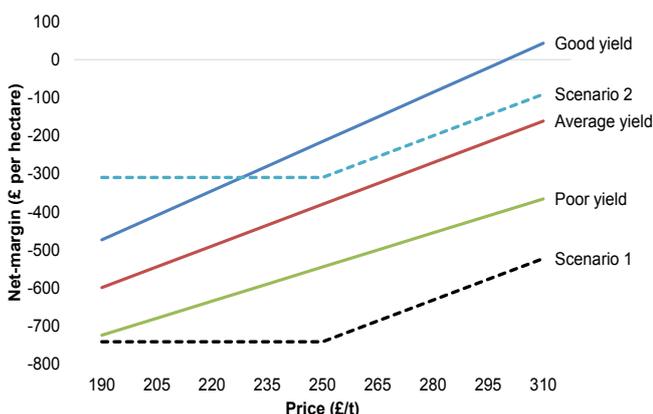
- Paying out cash to the farmer in the event of the market rising
- No physical yield risk
- The decision not to plant is protected

However, there is a cost to this – the option premium. In this example, we have used a May-16 call option. In theory this should be a Nov-16 option, but this far out there is no liquidity in the Nov-16 Paris OSR options market. Depending on how the market pans out, the option position can be reviewed through the growing season and possibly extended into Nov-16 / May-17.

This example uses an at-the-money May-16 call option from the Paris futures market at an estimated cost of £14/t (as at 5 June). Across the budgeted foregone yield of 3.65 tonnes per hectare this equates to £51.10/Ha. By not planting and buying a call option, **the farmer essentially has a virtual crop of OSR**, which will capitalise on upward price movements. Figure 2 examines the net-margin outcomes for:

- A crop that is planted this autumn with average, poor and good yields (taken from Figure 1)
- A crop that isn’t planted, incorporating the call option with Scenario 1 fixed costs
- A crop that isn’t planted, incorporating the call option with Scenario 2 fixed costs

Figure 2 Net-margin possibilities



Source: AHDB/HGCA

In this example staying with production, getting a good yield and achieving a high price gives the best outcome, but still only really breaks even. **The worst outcome is where the business with a relatively inflexible fixed cost base (scenario 1) decides not to plant.**

The business with flexibility in the fixed cost base (Scenario 2) that decides not to plant, provides some interesting outcomes. It’s important to note that a **negative net-margin is still achieved, but at much less risk**. The Scenario 2 outcome is actually better than that achieved with producing an ‘average yield’ and removes the risk of falling to ‘bad yield’ loss levels. So perhaps this is an alternative way of damage limitation and yield risk management during periods of low prices.

But for those businesses that are able to reduce their fixed costs, they would achieve net-margins almost equalling what they would with an average yield, without the risk. This is arguably a less risky way to speculate on the markets without having the physical risk of growing a crop.

Closing comments

Farmers are urged to explore the individual costs of production attributed to different crops when determining their crop rotations. Assuming that fixed costs are rigid could well be misleading and prevent the business from responding to market signals. For those with truly inflexible fixed costs an alternative would be to virtually ‘double crop’ the field, plant an alternative crop (such as beans) at the same time as operating on the OSR markets. The rationale here is again protecting the decision not to plant OSR in favour of another crop. We’ll consider this in our next instalment, looking at this new virtual variety of OSR.

In addition to fixed cost perceptions, the biggest issue for some businesses opting not to plant will be the loss of the cash margin. Although below cost of production, short-term cash margins are likely to be positive which could be the more pressing issue. In this scenario, a business is solving short-term cash flow, by essentially deferring fixed costs into future years – is this sustainable?

Key Points

- Profits from the 2016 OSR crop look slim and largely reliant on prices rises – there is an alternative to capture potential rises with reduced yield risk
- Making the decision not to plant needs good insight into the ‘switch-off-ability’ of fixed costs at the individual business level
- Short-term cash margins likely to fuel many decisions, but is this sustainable?

2014 Wheat Pricing Strategies update – the risk of failing to act

Over the life of the 2014 example pricing strategies, wheat prices fell by £50/t. This final update examines the ability of each strategy to manage the fall, while being able to take advantage of any short-term market appreciation. However, more than that, it identifies the clear risk to strategies that fail to act in a downward trend.

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Introduction

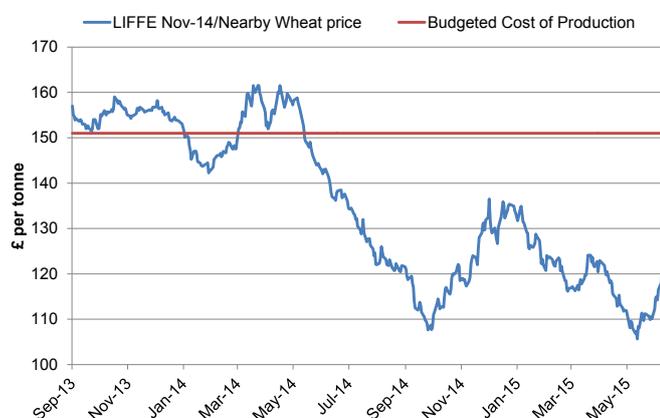
The 2014 wheat pricing strategies were launched over a year and a half ago, incorporating a range of techniques and tools to manage market risk. The exercise not only allowed a comparison of the net returns to the farm but a look at the level of exposure to market volatility and risk faced by each strategy. With all sales now made, this article summarises how each strategy fared over the period.

Market movements and farm profitability

Although the exercise did not relate to a specific farm, in order to look at the impact of market volatility on profitability, it was assumed that the farm was located in the East Midlands and grew 250ha of feed wheat. Based on Defra estimates of the average yield for the 2014 harvest and costs of production from the 76th edition of the Agricultural Budgeting & Costings Book, a 'break-even' price was calculated at £151/t.

Unfortunately, feed wheat prices have not been above break-even levels since May last year (Figure 1). Despite short-term rallies at either end of 2014, the long-term trend has been an overall fall in wheat prices. From £155/t in September 2013 (when the exercise began), prices fell by £50/t, hitting their lowest levels at the very end of the exercise.

Figure 1 Evolution of crop 2014 feed wheat prices since planting



Source: AHDB

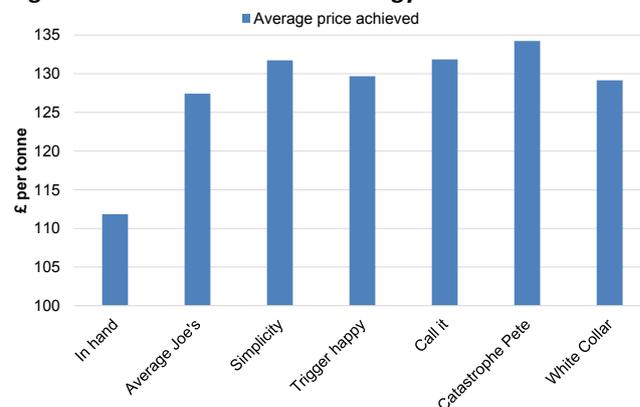
The challenge has therefore been how to manage the downward trend and minimise losses. For strategies with sales heavily weighted towards the end of the

marketing period, or strategies hoping for a late-surge rally, this has been costly and to their detriment.

Strategy performance

The average prices achieved for each of the example pricing strategies are shown in Figure 2.

Figure 2 Returns from each strategy



Source: AHDB

Post-harvest averaging – “In hand”

Unfortunately, this strategy serves as a **clear example of the risk of waiting until harvest before making any marketing decisions**. With the entire crop sold post-harvest, this strategy was left completely exposed to the market downturn. As the year went on, “In hand” became increasingly reliant on a late market rally, failing to manage the falling market and leaving the business vulnerable to further losses. The strategy finished with losses almost double those of any other strategy.

Averaging – “Average Joe’s”

This strategy made regular sales over the course of the 2014 calendar year, which allowed it to manage some of the volatility and the fall in the market. The strategy finished in sixth position, though it is noteworthy that there is only a £6.8/t difference between first and sixth positions.

The low ranking is partly due to the timing of sales. The strategy started in January 2014 and only three sales (out of 12) were made above the estimated cost of production. “Average Joe’s” reiterates **the importance of using market information available and adjusting marketing strategies as price trends develop**. If the strategy had brought forward sales pre-scheduled for later in the year, “Average Joe’s” would have finished higher.

Three thirds – “Simplicity”

“Simplicity” aimed to manage risk through both pre- and post-harvest sales. Sales were split into three selling lots, with two made pre-harvest and the remaining production spread over post-harvest sales.

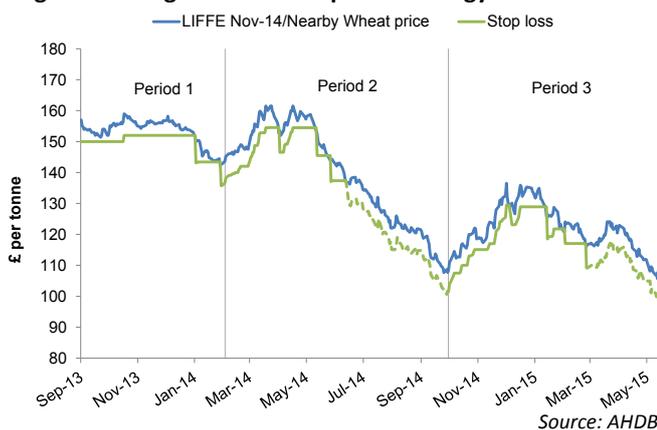
The strategy finished third having benefitted from forward sales made before the market fell through the farm’s break-even price.

Floating stop-loss – “Trigger happy”

“Trigger happy” was the highest ranking strategy for the 2012/13 harvest year but slipped to fourth this time round. The strategy is designed to take advantage of any price rises while limiting the impact of falling markets. This strategy is split into 3 selling periods, with 4 lots for each period. Any unsold lots at the end of the period are sold on the last day of that period.

Splitting the strategy into 3 selling periods was a means to prevent too much of the crop being sold in a short space of time. Unfortunately, under current market conditions, this has been to its disadvantage. The third selling period did not see prices rise above break-even prices and recorded some of the lowest prices over the last two years (Figure 3). With roughly a third of production sold in the third selling period, strategies that were less exposed to market volatility towards the end of the exercise quickly rose above “Trigger happy” in the overall rankings.

Figure 3 Progress of the stop-loss strategy



Options I and II – “Call it” vs “Catastrophe Pete”

These two strategies both incorporated the use of forward sales, post-harvest sales and Options to manage market volatility. The key difference between the two was that “Call it” bought an ‘at the money’ Call Option, while “Catastrophe Pete” bought an ‘out of the money’ Call Option for sales made in September. An ‘out of the money’ Call Option is slightly cheaper than one taken ‘at the money’, but the trade-off is that the market has to strengthen to a greater degree before the strategy sees any financial returns from the Option.

Interestingly, neither of the Call Options actually paid out. However, the use of the Call Options allowed these strategies to use aggressive forward selling, to take advantage of the higher prices whilst safe in the knowledge that *if* the market rose above the strike prices (which it didn’t) the strategies could cash in on the rise. This is a classic example of options enabling a farmer to have confidence to do something they wouldn’t normally do.

Both strategies proved successful in managing the long-term downward trend, shown by the fact that “Catastrophe Pete” was ranked first and “Call it” finished in second place. “Catastrophe Pete” finished higher than “Call it” due to the lower cost of the out of the money Call Option. Despite the additional cost, the use of Options secured minimum prices for the proportion of crop sold under them.

Options III – “White Collar”

This ‘minimum-maximum’ strategy covered post-harvest sales with a Put Option, thereby offsetting the risk of falling prices. To offset some of the cost, a Call Option was also sold at the same time, setting a maximum price. This strategy required the grain to be sold and both Options closed on the same day.

The strategy finished fifth but did prove effective in managing the falling market. The use of options secured a minimum price, while there was no disadvantage seen from a price ceiling due to the overall fall in market. If the market had strengthened beyond this price ceiling, however, this strategy would not have been able to benefit as much as other strategies.

Concluding comments from the 2014 risk management strategies

The strongest message to emerge from the 2014 example risk management strategies is the peril of failing to act in a downward market or failing to use market information to update strategies as market trends emerge. Strategies heavily orientated towards post-harvest sales, or with little in the way of mechanisms to manage falling markets, leave the farm business exposed and at risk of having little choice other than to accept prices on the day.

Key Points

- Managing market volatility is becoming increasingly important within the farm business
- Waiting until harvest can leave the business exposed to market volatility, with little ability to manage the market
- An effective risk management strategy uses market information and is updated as market trends become clearer

Margins plummet but policy continues to provide a prop for biodiesel

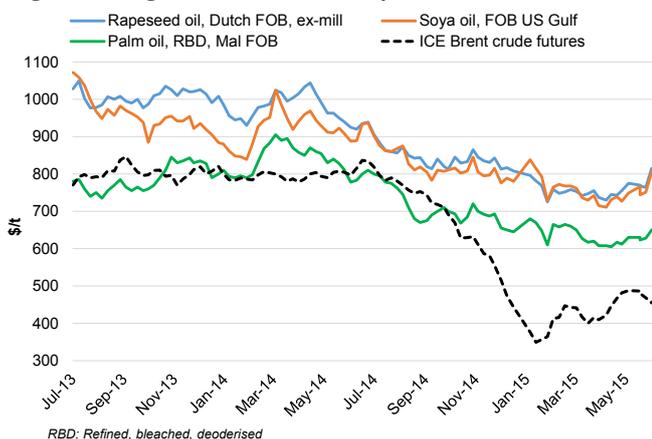
Lower crude oil prices relative to vegetable oil prices have hurt biodiesel production margins around the globe. However, while market conditions have been unfavourable, government intervention continues to exert an important influence on the industry's fortunes.

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Although there has been some recovery, **crude oil prices are still at the lowest levels seen since 2009**. Despite the price premium of vegetable oils over crude oil declining since January 2015 (Figure 1), it is still the highest since 2012/13. When prices plummeted at the start of 2015, the [subsequent effect on biodiesel, and thus vegetable oil demand was highlighted](#). Six months down the road, this article examines just how much of an impact lower crude oil prices have had on the biodiesel sector.

Figure 1 Vegetable and crude oil prices



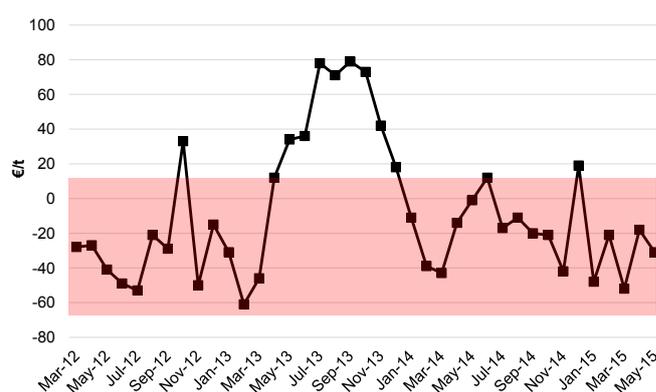
EU: biodiesel producer margins in the red

The latest data from analysts F.O. Licht, shows that, with the exception of December 2014, EU biodiesel producer margins have remained in the red since December 2013 (Figure 2). The fall in crude oil prices at the start of the current calendar year coincides with a considerable drop in the margin, which after some recovery in February, fell further still in March. The margin mainly depends on the vegetable oil (raw material) price and the biodiesel (product price). In December 2014, vegetable oil prices moved lower (Figure 1) and biodiesel prices increased. This situation then reversed in January. **With crude oil prices falling to five year lows, biodiesel prices were also forced to decline to some extent in order to try and remain competitive.** Since February, monthly biodiesel prices have remained fairly stable at around €760/t, but vegetable oil prices have been more volatile.

In January 2015, the average biodiesel blending share in Germany fell to 5.9% (a three month low). Aside from the fall in crude oil prices, the German

biodiesel sector was also affected by a change in legislation which came into effect on 1 January. Biodiesel mandates are no longer based on volumes but measured by greenhouse gas reductions. This new law has effectively lowered biodiesel consumption. However, overall diesel consumption in Germany has increased by 5% year-on-year. If diesel demand increases, it means that the amount of biodiesel that is required to be blended with it must also increase as the mandate is based on blended percentages rather than absolute volumes.

Figure 2 EU biodiesel producer margins



UK: steady increase in biodiesel demand

The latest statistics regarding UK consumption of renewable fuels in road transport fuel were published by the Department of Transport on 7 May. Up to 15 March 2015, biodiesel consumption accounted for half of all renewable fuels used in UK road transport. Previous data up to 15 December 2014 had shown the proportion of biodiesel consumed at 48%. In fact **there has been a steady increase in the percentage of biodiesel demand in UK road transport fuel over the past year.**

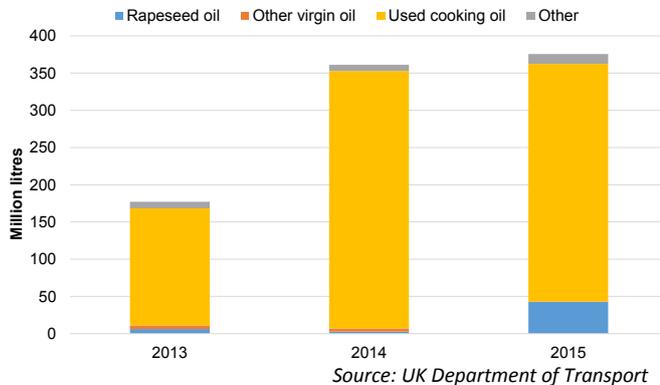
Figure 3 shows the feedstock origin of biodiesel consumed in UK road transport fuel for data received by the Department of Transport by 15 March between 2013 and 2015. In 2015, used cooking oil (UCO) remains the dominant raw material used but **the volume of rapeseed oil sourced biodiesel is over 15 times higher compared with the previous year.** Out of the 42.5 million litres of biodiesel originating from rapeseed oil that was consumed, 26% was sourced from the UK. The largest proportion (38%) of rapeseed oil based biodiesel was from France.

This latest data release suggests that UK consumption of biodiesel in road transport fuel has not been affected by lower crude oil prices, but this could be due to a variety of factors. The UK's mandate is also based on a blended percentage rather than absolute volumes, so higher diesel consumption would in turn favour more biodiesel usage to satisfy the mandate. Furthermore, there is still more data to be collated.

Margins plummet but policy continues to provide a prop for biodiesel

Data received by the Department of Transport by 15 June will be published in August and the final report for 2014/15 in February 2016.

Figure 3 Volumes of biodiesel, originating from various oils/fats, consumed in UK road transport fuel (data received by 15 March*)

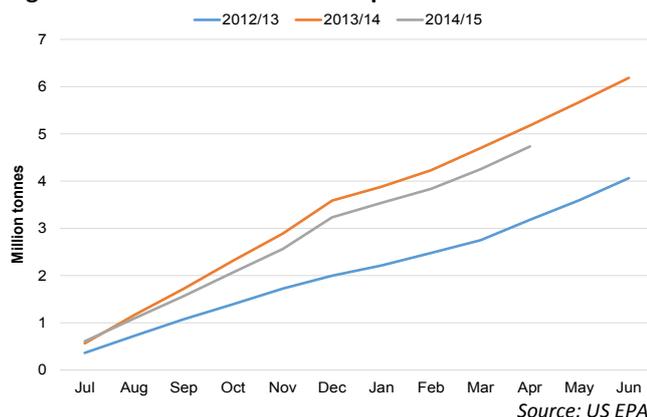


US: producers challenged by low crude oil prices

US biodiesel production (Jan-April 2015) has declined by 5.7% year-on-year according to the latest figures from the US Environmental Protection Agency (EPA). Figure 4 illustrates US biodiesel production according to crop years, and shows that while the output started off similar to the level seen in 2013/14, it has gradually declined in comparison with last season. Cumulative production between July 2014 and April 2015 was 4.7Mt, down 8.6% on the year.

One argument for the lower production could be that the US government has not yet renewed the \$1/gallon blending subsidy for 2015, but it's not as if this credit was available for much of the 2014 calendar year anyway (the subsidy was activated retrospectively for 2014 in December 2014). A similar scenario may play out for 2015. So, the lower production may be a reflection of the challenge faced by the US biodiesel industry in the face of low crude oil prices. Unlike in the EU, US biodiesel mandates are based on volumes produced rather than the percentage of biodiesel blended into regular diesel, so higher diesel consumption will have less of an effect.

Figure 4 Cumulative US biodiesel production



Some positive news for the US biodiesel industry was received on 29 May when the EPA announced their long awaited proposals for volume requirements of renewable fuels in the next few years. Biomass-based diesel volume requirements are suggested as 1.70 billion gallons for 2015, 1.80 billion gallons for 2016 and 1.90 billion gallons for 2017. The US biodiesel sector is generally encouraged by the increase in volumes although may push for higher targets during a 60 day public comment period which will end on 27 July 2015.

South America: mix of policy influences

According to F.O. Licht, biodiesel production in **Brazil** in March 2015 was the lowest in nine months at 259.5Kt. While this was 2.9% lower compared with February's output, it was still 8.5% higher year-on-year. The Brazilian government increased the biodiesel blending mandate to 6% from 5% in July 2014 which has helped increase production levels. Nevertheless biodiesel production margins have come under pressure in early 2015 as soya oil prices rose at the same time crude oil prices fell. The blending mandate is set to increase to 7% from 1 November this year, so this may help provide further support to the Brazilian biodiesel sector.

In Argentina, however, biodiesel producers may be feeling as if the government is making things more difficult. At the end of May, the export tax on biodiesel was retrospectively raised to 13.5% for April compared with 5% in March. Furthermore, the government cut biodiesel prices in April to the lowest level since January 2014, 20% lower year-on-year. The Argentine biofuels association, CARBIO, reported a 75% drop in biodiesel exports in April 2015 compared with a year earlier. The high premium of soya oil relative to crude oil is making discretionary biodiesel blending (i.e. producing biodiesel and blending it with diesel regardless of the mandate) virtually non-existent.

South East Asia: lower exports indicate decline in production

In Malaysia and Indonesia, biodiesel production is primarily for the export market rather than domestic consumption. Hence, the level of exports provides an indication of the level of production in both of these countries.

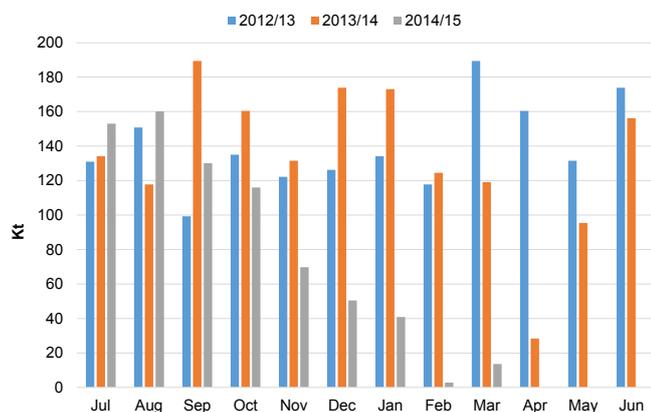
Despite hitting a 19 month high in February 2015, **Malaysian biodiesel exports** have been considerably lower, year-on-year, during March to May. In February, the price spread between local palm oil and diesel prices narrowed and so favoured higher biodiesel production. However, lower import demand from the EU and China contributed to Malaysian biodiesel exports in March-May 2015 totalling only a tenth of the amount that was exported the previous year.

Margins plummet but policy continues to provide a prop for biodiesel

At present, the Malaysian biodiesel mandate stands at 7% (regular diesel should be blended with 7% of biodiesel), but the government has announced plans to increase this percentage to 10% by October 2015. This should help increase biodiesel output and demand if implemented, but discretionary blending remains an important aspect in the Malaysian biodiesel sector and this will ultimately be determined by the price spread between palm oil and crude oil.

Discretionary blending of biodiesel is also a key source of palm oil demand in **Indonesia**. Indonesian biodiesel exports have been markedly lower since December 2014, although a year-on-year decline has been seen for every month since September 2014 (Figure 5). For January-March 2015, Indonesian biodiesel exports were only one-seventh of the total exported during the corresponding time period in 2014.

Figure 5 Indonesian biodiesel exports



Source: Statistics Indonesia

In order to support the domestic biodiesel sector, the Indonesian government has proposed to increase the biodiesel mandate from 10% to 15% by Q3 2015 and it may rise further to 20% in 2016. The increase is to be mainly funded by the imposition of a levy on palm oil and processed products. The government plans to lower the export tax on crude palm oil to help offset the additional cost of the levy to processors. However, delays in implementing the levy are casting doubts as to whether this method of raising subsidies for a higher mandate will be achieved; “administrative issues” have postponed the process several times since the initial announcement was made in March 2015. Furthermore, as seen in the past, the presence of a mandate doesn’t necessarily mean that it will be rigorously enforced or achieved.

Closing comments

Lower crude oil prices and rising premiums of vegetable oil prices have not helped the economics of biodiesel production around the globe. Government policy is certainly having an impact on production levels, though whether or not this has benefited

biodiesel producers varies from region to region. Things have been far from ideal for the global biodiesel sector but they could have been much worse if it was solely at the mercy of market forces.

This means that vegetable oil demand for biodiesel production has perhaps not suffered as much as it could have and looking ahead, increasing mandates in some areas such as the US and South East Asia provide some promise.

In the EU, however, a 7% cap on biofuels produced from food crops has been approved and the emphasis is towards using waste or recyclable materials. This is evident from the latest UK consumption data where UCO dominates as the main feedstock for biodiesel employed in road transport fuel.

The opportunities for increased demand for vegetable oils in biodiesel production are limited in the EU and while the proposed mandate increase by the US EPA looks to be a step in the right direction, it still falls short for many. The developing biodiesel industries in South America and South East Asia are likely to offer more promise in terms of higher biodiesel supply and demand. Although government policy is shaped towards supporting local biodiesel production, especially in Malaysia and Indonesia, levels of discretionary blending will ultimately depend on relative prices and economics. Should the looming threat of El Niño materialise in South East Asia and cause a spike in palm oil prices while crude oil prices remain relatively low, there might be a bigger challenge ahead for not only the local biodiesel industry, but around the globe as other vegetable oil prices will also be affected.

Key Points

- Higher premiums of vegetable oils over crude oil dent biodiesel producer margins
- Government policy remains a large support for the industry in most cases
- El Niño has the potential to aggravate things further

Australian crop production faces east – west split in 2015

The El Niño weather pattern is of some concern for producers in eastern Australia. However, a separate weather phenomenon, arising from the warming of sea surface temperatures in the Indian Ocean, indicates good rainfall, and a more positive outlook for the growing season in parts of Western Australia.

Sarah Nightingale, External Contributor

23 June 2015

Introduction

The sowing of winter crops in Australia is nearly complete following an early start and good rains in April. With Australia being a major supplier of grain to Asia and the Middle East, prospects for the 2015/16 crops are important with regard to availabilities for these markets as well as global trade.

Pulse area grows while wheat remains unchanged

The latest Australian Crop Report, issued by the Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES) (10 June), shows **wheat sowings for the 2015/16 season are relatively unchanged from last year**, at 13.8Mha (Figure 1).

Figure 1 Area and Production forecasts for Australian winter crops

	Area (Million hectares)				Production (Million tonnes)			
	2013/14	2014/15	2015/16	% ch y-y	2013/14	2014/15	2015/16	% ch y-y
Wheat	12.61	13.81	13.79	-0.1%	25.30	23.67	23.60	-0.3%
Barley	3.81	3.84	3.99	3.9%	9.17	8.01	8.25	2.9%
Canola	2.72	2.71	2.35	-13.5%	3.83	3.41	2.96	-13.3%
Pulses*	1.46	1.46	1.82	24.6%	2.18	1.92	2.33	21.5%
Oats	0.72	0.68	0.80	17.7%	1.26	1.10	1.38	26.3%
Triticale	0.08	0.13	0.11	-16.0%	0.13	0.23	0.14	-37.3%

* Chickpeas, faba beans, field peas, lentils and lupins

Source: ABARES

The barley and oat areas are up 4% and 18% year on year, and **there has been a large increase (25%) in the area sown to pulses**. The most significant increase in pulse area is for chickpeas, which is up 60% year on year, particularly the *desi* varieties. This is in response to high world prices following a severe production shortfall in India.

There is a reduction in the areas sown to triticale and canola (rapeseed) across Australia in favour of more profitable crops. In South Australia and Victoria, canola area was replaced to some extent by barley, lentils and faba beans, while growers in Western Australia switched land to oats and lupin cultivation.

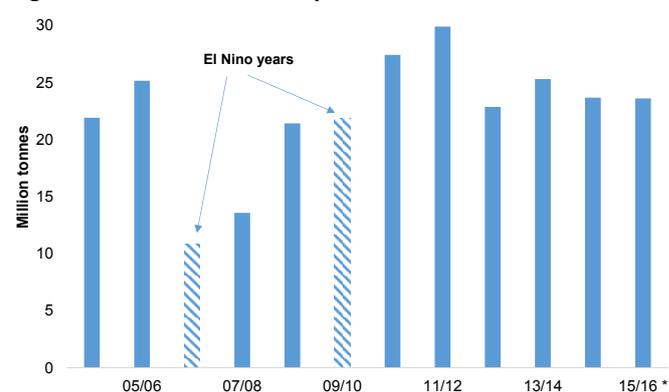
Wheat production currently looks likely to remain similar

While ABARES in June, reduced its 2015/16 wheat output forecast slightly from its previous estimate, production is currently forecast only 0.3% lower year-on-year.

However, the strengthening El Niño weather pattern is causing some concern for growers in New South Wales and southern Queensland, which tend to have very dry

growing seasons in El Niño years. Figure 2 shows how wheat production is generally lower in such years.

Figure 2 Australian wheat production



*ABARES June forecast

Source: ABARES

Will El Niño impact the east?

The Australian Bureau of Meteorology currently forecasts a “drier than normal” winter for southern and inland Queensland, northern and eastern New South Wales (NSW) and eastern Victoria. Currently **wheat production in NSW is forecast to decline by 2% year on year (to 6.2Mt) despite an unchanged sown area**. The quantity and timeliness of further rainfall in eastern Australia will be critical for the final yields of winter crops.

On the other hand, western parts of NSW are forecast to benefit from rainfall, which is the result of a weather phenomenon separate from El Niño, caused by a warming of the surface of the Indian Ocean.

Better outlook for Western Australia

Like eastern Australia, Western Australia (WA) saw good planting and germination conditions through April and May. Furthermore, good levels of rainfall forecast over the next three months is expected to lead to higher yields being achieved in comparison to last year. ABARES currently forecast that **wheat production will rise by 4.2% year on year (to 9.3Mt) in WA**, the principal exporting state, and **barley production to rise by 7.6% (to 3.3Mt)**.

Around 80% of wheat produced in WA is exported, predominantly to Asia and the Middle East. Furthermore, there has been growing demand for Australian malting barley from China, Japan and India. The recent China-Australia Free Trade Agreement, which will see the removal of the 3% duty on Australian barley imported into China, is expected to boost barley exports in the future.

Concluding comments

While the strengthening El Niño is a concern for crops in eastern Australia, the yield outlook is by no means yet clear. The timing of any rainfall over the next few weeks will be critical for these crops.

Meanwhile, the outlook for crops in Western Australia is currently more positive, but again, rainfall at certain growth development stages will be vital for crops to optimise yields.