

EU Biodiesel and Potential Impacts on Canadian Exports



May 2020

Key Findings:

- The EU has been a critical export market for Canadian canola this season, although the reduction in diesel consumption puts the future biofuel demand component into question.
- Any reduction in the EU rapeseed crush would come straight out of import potential. The extent that this impacts Canada's export opportunity for the coming season will be a function of the size of the EU and Ukrainian crops. It's possible that a reduced crush is partially offset by smaller crops in those regions.
- Price spreads between the EU and Canada will be the primary driver of how much business gets done in 2020/21.

Introduction

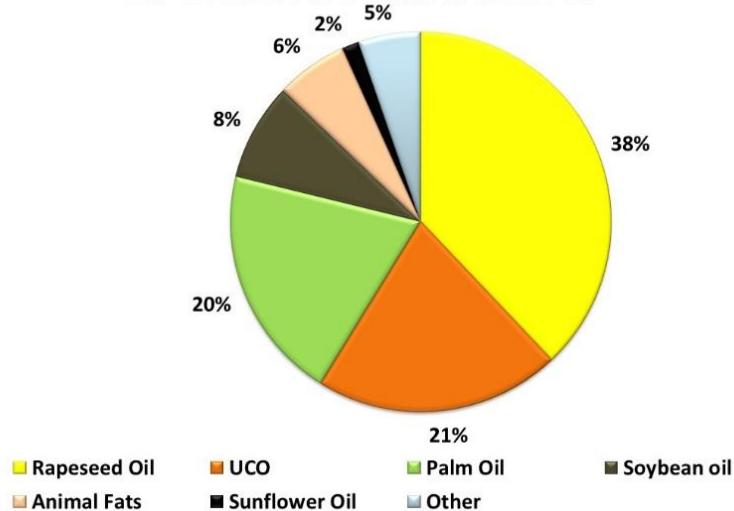
The EU has been a particularly important export market for Canadian canola this season. Exports to the end of March were 1.41 mln tonnes, compared to 642,484 tonnes for all of 2018/19. The bigger volumes have offset more than half of the reduction in shipments to China. The increased EU interest is due to a drop in their own domestic production. This was driven partially due to unfavorable growing conditions in 2019, but even more so by the decline in seeded area. The lower plantings seem to be a permanent trend as the ban on neonicotinoids has caused farmers to turn away from growing rapeseed. The gap between EU crush demand and production is filled with imports, primarily from the Ukraine and Canada.

Approximately half of the EU rapeseed crush is for biodiesel consumption. Given the reduced fuel usage during the COVID19 pandemic, this raises the important question of what the potential impact will be on Canadian exports to the EU going forward.

Rapeseed Within the EU Biodiesel Industry

The EU produces approximately 14 – 15 bln litres of biodiesel annually. In 2019 rapeseed oil made up 5 MMT of the total biodiesel stock, about 39% of the total. This equates to 12.5 mln tonnes of rapeseed. Rapeseed's share of the feedstock has been declining in recent years, partially due to lower available supplies from the smaller production.

EU Biodiesel Feedstock 2019



Fuel Demand in Pandemic and Post-Pandemic Periods

It is estimated that diesel fuel consumption in Europe was down 50 – 60% in March and April. The speed at which consumption recovers is dependent on the pace at which economies start to open up and return to 'normal'.

It's reasonable to expect a transition period where fuel consumption gradually moves to a normal level (e.g. 70% of normal in June, 85% in July, etc.). We also anticipate that fuel consumption won't fully recover to 100% of what it was pre-COVID19. Economic recovery will take a long time and there are likely some permanent effects that will be negative for consumption (e.g. people working from home more frequently, less business and leisure travel, overall economy that struggles to return to pre-pandemic levels).

When one considers a few months of walking toward a final 'new normal' of 90% of previous fuel demand, it's not out of the question that biodiesel production could drop 15% when viewed across a full year (one month of 65%, one month of 70% and one month of 80% requires eight months of 90% to have an average of 85% of consumption across that full time period). This might be too pessimistic, but it is within the scope of possibility.

The Effects on Rapeseed Crushed for Biodiesel

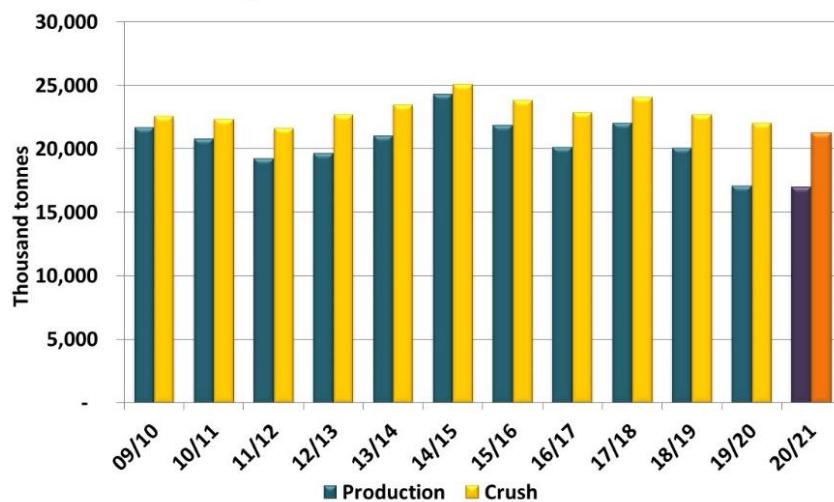
Even if biodiesel production declines by 10 – 15%, it may not mean that rapeseed crushed for biodiesel falls in an equal proportion. For example, 20% of biodiesel feedstock comes from recycled vegetable oil and used cooking oil, where availability may drop due to reduced restaurant traffic. Biodiesel from rapeseed shows good stability and winter performance because of the makeup of its oil, which could make it less likely to see a full drop-off.

When considering some offsetting effects, it may be reasonable to assume a 5% reduction in rapeseed crush for biodiesel. This still equates to 625,000 tonnes less rapeseed that is needed in the EU. This will come out of imports.

Effects on Canadian Exports to the EU

The effect on Canadian exports to the EU will depend on several factors. First is the total import requirements for the EU. EU rapeseed production is expected to be approximately 17 mln tonnes, similar to last year. Challenging conditions could see the crop come in even lower. EU imports are forecast at 6 mln tonnes for the current 2019/20 crop year. A reduction in crush by 625,000 might result in a similar reduction in import needs in 2020/21. Old crop supplies are tight, so there is little cushion to fall back on for the coming year.

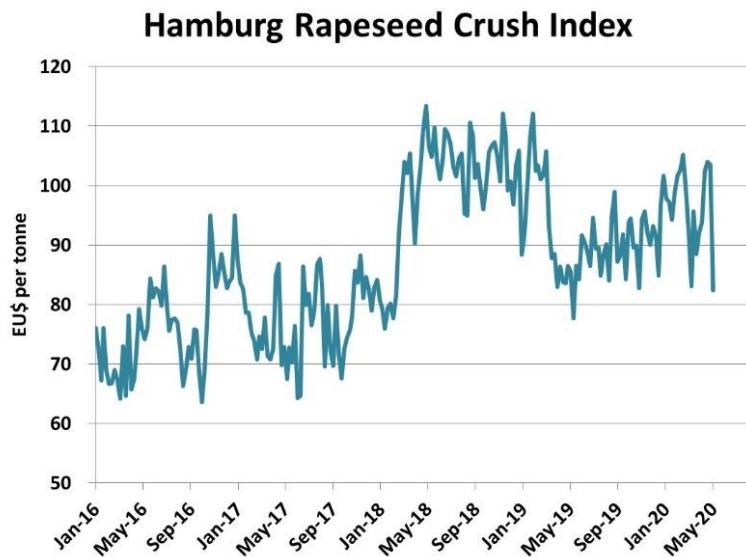
EU Rapeseed Production & Crush



However, this may not all come from Canada's share. Ukraine's rapeseed crop looks to be lower than the 3.3 mln tonnes grown last year. Production estimates range from just below 3 mln tonnes to as low as 2 mln tonnes. Last year Ukraine exported nearly 3 mln tonnes to the EU, with roughly 3 mln tonnes being provided from other countries (mostly Canada and Australia). A smaller Ukrainian crop means that there is a larger hole needing to be filled from non-Ukrainian sources. Even if EU import needs are 625,000 tonnes lower in a post-COVID environment, much of this could be offset by lower EU and Ukrainian production, leaving the import opportunity nearly unchanged. Conversely, if EU and/or Ukrainian production comes in higher than current expectations, this will come primarily out of Canadian exports.

It's also worth noting that back-to-back smaller crops in Australia has reduced their footprint in the EU export market. A rebound in their production could add some additional competitive pressure, although their presence will be more significant with non-GMO canola, which likely wouldn't end up in biodiesel due to its premium.

It's also worth noting the importance of how crush margins will influence volumes. For example, if the market structure is such that rapeseed crush margins are favorable despite reduced biodiesel demand, volumes may end up remaining relatively strong. EU crush margins have declined over the past week, but have also been very volatile in general.

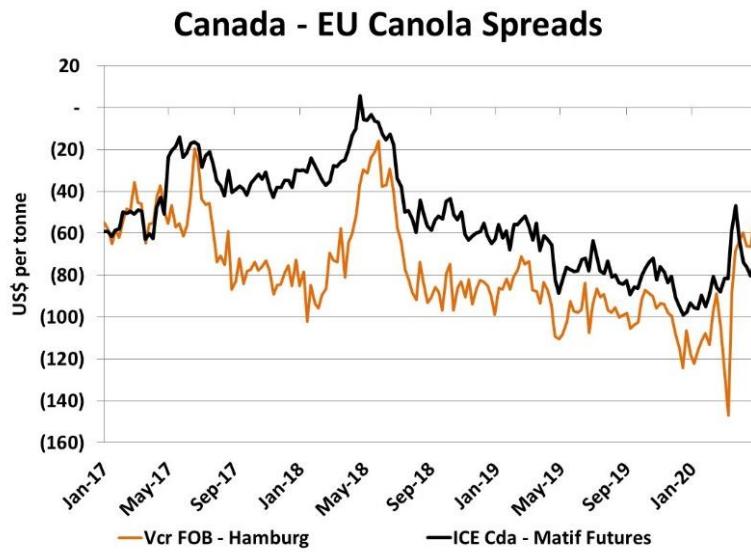


Perhaps where Canadian shipments might be affected is in the timing more so than the volumes. So far exports to the EU have remained steady, and stocks sitting in Thunder Bay suggest at least a few more shipments will be made in the coming weeks. This is likely a reflection of companies fulfilling previous commitments. However, given the sharp reduction in fuel consumption, there will be inventories building that need to be worked through. We are also getting closer to the EU and Ukrainian harvests. All of this could push back some 2020/21 Canadian sales later into the crop year.

Finally, price spreads will be the ultimate determinant of how much Canadian canola finds its way into Europe. The wide price spread between European and Canadian values encouraged the strong export movement over the past year. Those values have narrowed more recently. The ICE Canola - Matiff rapeseed spread is roughly in the middle of the range over the past year. But the Vancouver FOB discount relative to Hamburg is at its narrowest point in nearly two years, compared to being exceptionally wide in March.

It's also interesting that the spread from Vancouver had been widening since the fall, and the latest January to March window saw 485,500 tonnes of exports to the EU. Normally shipments would be small during that period due to the Great Lakes freezing, but the price spread was clearly wide enough to make business feasible out of Vancouver.

The price spreads this coming fall and early winter will provide an indication of the EU export demand outlook. This also assumes that trade relations between Canada and China don't change – any significant increase in Chinese purchases would quickly tighten up the Canadian canola balance sheet to the point where EU imports could get squeezed out.



Summary Comments

- Old crop Canadian exports to the EU may dip somewhat, but not a great deal as previously booked business gets executed. It's unlikely that much new business gets done in the short term due to reduced demand and a narrowing of the price spread. The long lag time for Canadian canola to reach the EU could also be a limiting factor.
- Canadian export potential for 2020/21 will largely be driven by how the final EU and Ukrainian yields come in. Crop sizes that meet current expectations would leave the Canadian opportunity similar to this past year, even if total EU demand dips due to smaller biodiesel production. Any upward revisions to crop sizes would come primarily out of Canadian exports.
- It's possible that Canadian exports get pushed towards later in the 2020/21 crop year. Ongoing EU imports in recent weeks combined with a drop-off in demand will result in some building of stocks ahead of the EU and Ukrainian harvest. This creates better potential for Canadian shipments into later winter and spring.