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## International Update

### Oiling the wheels of Indonesia's economy

#### Profiling the global demand for palm oil

Palm oil is the fastest growing sector in the global vegetable oils market with Indonesia and Malaysia as key producers. Worldwide consumption of palm oil is increasing by an average of 6% a year, twice the annual growth rate of other vegetable oils.

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Faced with this bonanza and higher returns from palm oil compared to other crops, palm oil production has expanded rapidly in recent years. A new report by Rabobank's Food & Agribusiness Research (FAR) focuses on the current state of the palm oil industry in Indonesia since it has more land for expansion and lower production costs. "There haven't been any recent reports about palm oil," says Aditya Kusuma, Manager Strategic Advisory & Research at Rabobank Jakarta. "So this update provides information to any players interested in the industry."

#### Indonesian perspective

In Indonesia, palm oil is mostly consumed as cooking oil, but there are growing facilities for other palm oil-based products like oleo-

chemicals, margarine, soaps and cooking ingredients. Although this represents a huge domestic market, Indonesia exports over two thirds of its palm oil.

Palm oil accounts for 1.5% to 2.0% of Indonesia's annual GDP. It is also a leading contributor to the country's agricultural trade surplus. This makes palm oil Indonesia's most important agricultural commodity and fourth most important export commodity after oil and gas.

The Indonesian government is keen to expand palm oil production. To encourage growth it provides low-cost capital, makes land available and levies lenient export duties.

### **Global prices and demand**

Global market prices have declined over the last two years because of better-than-expected crops and oversupply in the worldwide market. However, prices are currently rising again because of seasonal declines in stock, a slowing in year-on-year growth and a drought in South Africa which has reduced production of soybean, a palm oil substitute and competitor crop.

A remarkable increase in global demand is also exerting upward pressure on prices. China is an important export destination for Indonesian palm oil and consumption there is expected to rise significantly as the standard of living improves. India is likely to increase palm oil imports as production of vegetable oil crops falls as a result of climate change. There are also opportunities in the United States and the European Union, but Indonesia would first have to improve palm oil quality and meet these regions' high environmental standards.

The biodiesel industry is also having an impact on demand. With crude oil prices at an all-time high, people are turning to the biodiesel industry as an alternative source of energy. This industry drives consumption of rapeseed oil which in turn drives demand from the food industry for other vegetable oils like palm oil.

### **Environmental concerns**

As the palm oil industry has grown, so have concerns about environmental damage, social problems and sustainability. To dispel these concerns and encourage investment, state and private sectors have initiated multi-partnerships, roundtable discussions, social and environmental studies as well as promotional campaigns with NGOs.

**Code of conduct**

As a responsible financial services provider for food and agribusiness, Rabobank has had a code of conduct for financing palm oil plantations since 2001. This code includes specific conditions imposed on clients to limit the negative environmental and social impact of palm oil production. The code also includes criteria for sustainability and an environmental due diligence process.

Rabobank is also a member of the Roundtable on Sustainable Palm Oil (RSPO). The former Secretary General of the RSPO recently addressed Rabobank's Asian Senior Managers Conference on the risk factors involved in palm oil financing. In addition, Rabobank is sponsoring the third roundtable meeting on sustainable palm oil in November this year.

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