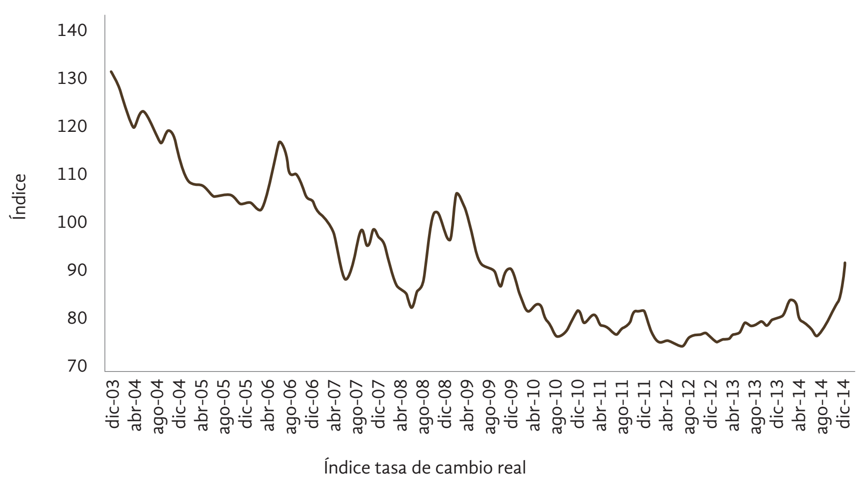
Depreciation of Colombian Peso Relieves Oil Palm Competitiveness

The devaluation of the Colombian peso observed between late 2014 and early 2015 is very good news for oil palm growers, in particular because it comes at a time when international prices of oils and fats are falling. Considering that these prices are benchmarks for domestic palm and kernel oil prices, this will doubtless help offset the expected reduction in revenues for oil palm growers as a result of lower international prices.

The exchange rate is the main price in an open economy, its importance lying not only on the fact that it is used to value goods coming from the rest of the world in local currency and vice-versa, but also on the fact that it is one of the key determining factors in the flow of goods, services and capital with other countries.

The evolution of the nominal exchange rate and of the actual exchange rate index shows that, as of 2003, the Colombian peso had been on a trend of appreciation which even intensified during the first few years of the second decade of this century (Figure 1), resulting in an overall 33% appreciation over the past 10 years. Some experts believe that Colombia had been showing signs of what economists term “Dutch disease”, a phenomenon created by a stronger currency as a result of the mining and energy boom and also by higher levels of direct foreign

Figure 1. Evolution of the actual exchange rate index in Colombia. Source: Banco de la República (Central Bank)



investment, jeopardizing profitability and the productive performance of the other tradable sectors of the economy, as in the case of industry and agriculture.

Consequently, it was clear that the appreciation of the Colombian peso did not come about as a result of economic fundametals or of increased productivity of the country's productive sector. In those circumstances, labor-intensive sectors such as agriculture were faced with a gradual increase in the cost of labor resources – which in essence is non-tradable – and a reduction in revenues coming from the sale of products both in the local as well as the international market. In the former, the drop in revenues was due to competition against cheap imported products and, in the latter, due to the fact that for every dollar sold abroad increasingly less pesos were received, compromising the profitability of the sector.

The recent depreciation of the Colombian peso is due mainly to the expectation created in the markets as a result of the interest rate increase in the United States and the collapse of the oil price, which according to some analysts will not recover in the immediate future. This devaluation reorganizes the economic and productive landscape for a large portion of the agricultural and industrial sector and, in particular, gives new air to oil palm agribusiness in Colombia.

Indeed, while international palm oil prices have dropped 25-30% in Europe and Southeast Asia between March 2014 and January 2015, the oil palm sector has been able to lessen the impact of this contingency to a large extent thanks to the effect of depreciation of Colombian peso in 19 % during the same time period.

This situation in which international palm oil prices and the peso/dollar exchange rate pull in opposite directions is not new and has actually been the norm in the Colombian oil palm sector several times. A review of the past five years has shown that, during the first half of 2010, the second half of 2013 and the third quarter of 2014, revenues for the sector fell as a result of the drop in international prices, offset by exchange rate levels. In contrast, between the second half of 2010 and the second half of 2012, high prices helped mitigate and overcome to a certain degree the impact of the Colombian peso revaluation (Figure 2).

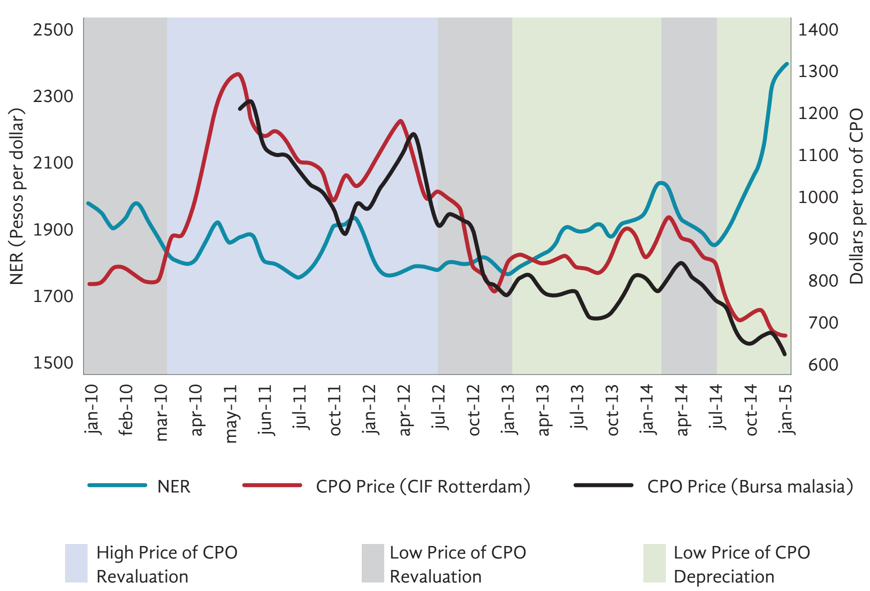


Figure 2. Evolution of the nominal exchange rate (NER) and international reference prices for crude palm oil.

Source: Fedepalma, based on Banco de la República and Reuters data.

This begs the question of whether this improved exchange rate level will remain in time. The answer is uncertain, but the only thing that is clear is that there are very many variables that affect the exchange rate, increasingly exposed to multiple external and internal shocks of the Colombian economy, and this results in high volatility.

The situation being what it is, although there are signs of an upward trend in the exchange rate, its volatility impacts planning and investment conditions in the productive sectors of the economy, as is the case of oil palm. The phantom of volatility may manifest in the form of downward tensions in the exchange rate and lead to undesired demand fluctuations, disturbances in the production of tradable goods, and adjustment-related unemployment.

In view of the above, and acknowledging the challenges that maintaining an exchange rate that responds to the essentials of the national economy and helps mitigate economic volatility poses for policy-makers, the path that offers most certainty for the producers is to rationalize their production costs and to close productivity gaps. This will require the adoption of the best practices available in an attempt at strengthening the competitive position of agribusiness and improving oil palm fruit and palm oil yields per hectare, without neglecting the development of additional processes designed to increase value added from this activity.