Food and Agribusiness Market Update

Industry Consulting Team | Q3 2021

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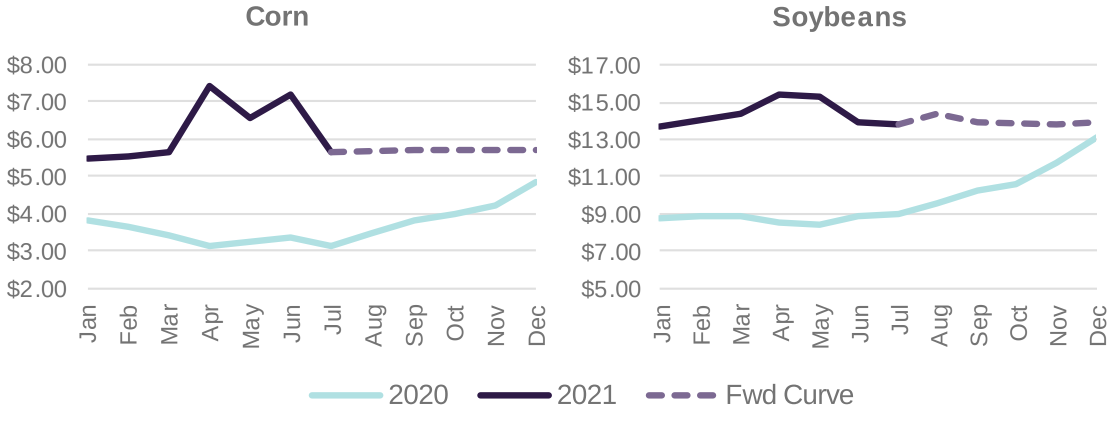
Highlights:

- As expected, food prices have increased over the last few months with commodity prices and labor challenges being the driving forces.
- Commodity prices are being affected by decreased supply chain operations and previous forecasting errors.
- Commodity prices will remain elevated through the end of the year as this harvest won't be sufficient to overcome the perceived shortage in safety stocks.
- In addition to rising prices, wages are also rising in response to an ongoing labor shortage.

Why Higher Food Prices are a Good Thing

I've been signaling that higher food prices were on the horizon, and the last few months have brought a flurry of pricing activity by several branded food marketers. Similarly, fresh food prices in grocery stores are on the rise, and many restaurants are now pondering a second or third menu price change given the continued cost pressures and uncertainties within the supply chain. Clearly, commodity prices and labor challenges have been the immediate driving forces in these inflationary times, but this industry is earmarked by volatility being a part of the fabric with which these commodity-rooted industries are woven. At this stage, it's more interesting to consider the duration of this cycle, even if the answers remain unclear.

Commodity Prices: The commodity charts below help visualize the magnitude of the year-over-year price increases that have occurred in the corn and soybean markets. As alluded earlier, these price levels are not unprecedented, but the fundamentals driving them certainly are. With the underlying supply chain not operating at full strength due to global logistics slowdowns, forecasting supply availability or quantifying foreign demand has been difficult. In fact, as we experienced downward revisions in certain commodity carry-outs over the winter months, we saw the inflationary effects of these forecasting errors have a material impact on pricing. Uncertainties of this nature simply present risk, leading more participants to seek price protection, thus driving the market higher.



Please call your attention to the futures prices that are plotted on the charts above which reflect the expectation that commodity prices will remain elevated through the end of the year. Of course, these markets don't account for all of the grain traded in the U.S., let alone the world, but they are useful as a value barometer when one considers practical interpretations. Despite the expectation of a strong harvest, these markets undoubtedly reflect the risk that we won't, which in and of itself may offer some short-term price relief in October if a weather event is avoided. Regardless of short-term movements, this crop won't be sufficiently large enough to replenish the gap in safety stocks, which signals this commodity cycle is not a one year event.

Commodities (Cont.): The current USDA feed grain projections are reasonable approximations at this stage, particularly if we stay focused on the relative changes being reported. Again, I don't think a record crop in the fall will be sufficient to cause a collapse in prices. Despite the USDA projection that this corn crop may slightly outpace usage in the year ahead, June 30 corn stocks were reported 18% below prior year levels, and the current stocks-to-use ratio was pegged slightly below 10%. Considering that the optimal range for stocks-to-use is probably in a range of 13%-17%, it's easy to see that we are playing from behind.

Understanding the drivers of these commodity cycles can help predict both magnitude and duration, though never with certainty. When one layers in the supply chain challenges that are hampering raw material availability, the complexities are endless. It is vital to remember that global trade flows, which impact all commodities, are at a fraction of the normal pace, which has forced all participants to reinterpret these data points and reevaluate traditional ways of doing business.

Labor: There are several perspectives on the existing labor shortage, and its potential solutions, that I find interesting. At some point, the post-mortem on COVID-19 will include an examination of the ways in which employers and employees have been misaligned. However, in the midst of this continuing crisis, the most common response has simply been to raise wages. Once again, these added costs have had a direct impact on food prices, but how long these increases last, or even whether they may be permanent, is hard to predict. At first glance, rolling back wages may seem unthinkable, but consider the following:

- Turnover rates for food manufacturers have been consistently above 100% for several years. A typical food company will report that 20% of its workforce is permanent and the remaining 80% is transitory. This gives employers a unique ability to lower wage rates in response to market conditions as new employees are hired, thus implying that recent wage rate increases are by no means permanent.

- In areas where state benefits have expired, most food companies are reporting a noticeable improvement in the quality of job applicants approximately 30-45 days after expiry. This is not to be misinterpreted as a return to pre-pandemic levels; it is simply a reflection of the reality millions of American workers will face in the months ahead.

- In some cases, companies have smartly aligned compensation increases with productivity standards or used performance/milestone bonuses to signal these payments are discretionary. This should provide employers with maneuverability when labor pools improve.

Impact on Food Prices: In the commodity discussion above, cyclicality assures us that current trends will reverse course; it's only a question of when. What I do not want to imply is that food prices will follow the same pattern. Our food system is rooted in commodity industries, but it is also the most diverse and differentiated food supply in the world, which drives significant value with consumers. The reality is that a good share of today's price increases will have lasting effects long past this commodity cycle, which is perfectly acceptable because the revenues are being directed to the right people: farmers, ranchers, laborers and other producers that have struggled historically due to receiving a disproportionate share of industry revenues. In that respect, if food manufacturers can embrace and leverage the power of their supply chains and these critical commodity partnerships, the rising tide will have a way of lifting all boats.