# Food and Agribusiness market update

**Industry Consulting Team | Q4 2021**

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### Highlights

- Commodity prices are not the primary driver of rising food costs - labor and indirect costs such as freight and transportation present more severe challenges.
- Higher commodity prices have critical benefits for the future health of our domestic food industry.
- Despite higher nominal grain prices, which will continue into next year, price volatility has not increased and trading markets remain highly efficient as risk management tools.

## We are in this for the long haul

Consumers are facing significant food price inflation, which will continue well into next year. Despite the scarcities that are occurring within the food supply chain, there has been no shortage of misinformation about the impact that higher commodity markets are having on consumer prices. Without question, higher corn and soybean prices will result in higher meat costs, and with cotton recently eclipsing $1 per pound, clothing prices will also trend higher. However, the recovery from this pandemic will not look like previous commodity cycles, and that's because commodity prices are not the primary driver of those skyrocketing prices you see at the grocery store.

In my previous issue, I noted that higher commodity prices have the positive attribute of raising the producers' share of the gross receipts. That was not a short-sighted observation intended to ignore any accompanying consequences; clearly, when wheat prices rise, so will the price of bread. My overwhelming sentiment was that our industry is going to need a sustained period of higher commodity prices to help growers and producers not only meet current demand, but also rebuild stock levels. It is unfair and inaccurate for downstream food manufacturers to signal to consumers that commodity prices are the primary culprit. The truth of the matter is that higher commodity prices are the primary factor that will rescue our food supply from continued shortages. Commodity cycles in 2008 and 2012, for example, drove severe disruptions in the protein markets, but this cycle hasn't been the cause of anything; it has been an effect.

Let's take a closer look at how a couple of large, multinational food companies have addressed commodity price inflation over the last few quarters:

- General Mills manufactures cereals and snacks, which makes it a significant consumer of wheat, corn, and oats. For its 2021 fiscal year ended May 31, 2021, the company reported a $366 million increase in cost of sales due to higher raw material prices, which was partially offset by a $139 million gain related to mark-to-market valuations of commodity positions. This net increase of $227 million attributable to higher commodity prices represents an increase of 2.0% from prior year cost of sales, totaling $11.5 billion.
- Tyson Foods is a protein producer and major feed grain user with strong interests in corn and soybean markets. For the nine months ended July 3, 2021, Tyson reported an 8.0% increase in cost of sales, almost all of which ($2.2 billion) was attributable to higher input costs. Look further to see that the direct impact of higher feed grain prices was $175 million (net of derivative gains) for the nine months, which had the effect of increasing Tyson's COGS by only 0.6% from the prior year.

These cost pressures are real, and they will persist, which is why both companies have correctly taken aggressive pricing actions this year to protect margins. My concern is that an increasing number of consumers will expect food prices to immediately retreat when commodity prices ease, but with so many added variables, the equation is no longer that simple. If you examine some of the other notable items that comprised Tyson's $2.2 billion increase in input costs, you'll see these takeaways, all of which were more material to earnings than the underlying movement in feed grain prices:

- Freight and transportation costs were increased by $200 million
- Grow-out expenses and outside chicken purchases increased by $210 million
- Prepared foods costs increased $265 million due to materials, packaging, and labor

In order to be solutions-focused, you have to be able to correctly identify the problem. Our food supply chain has no shortage of challenges, but at this particular juncture, higher commodity prices are not our problem, just as lower commodity prices would not soon cure it.

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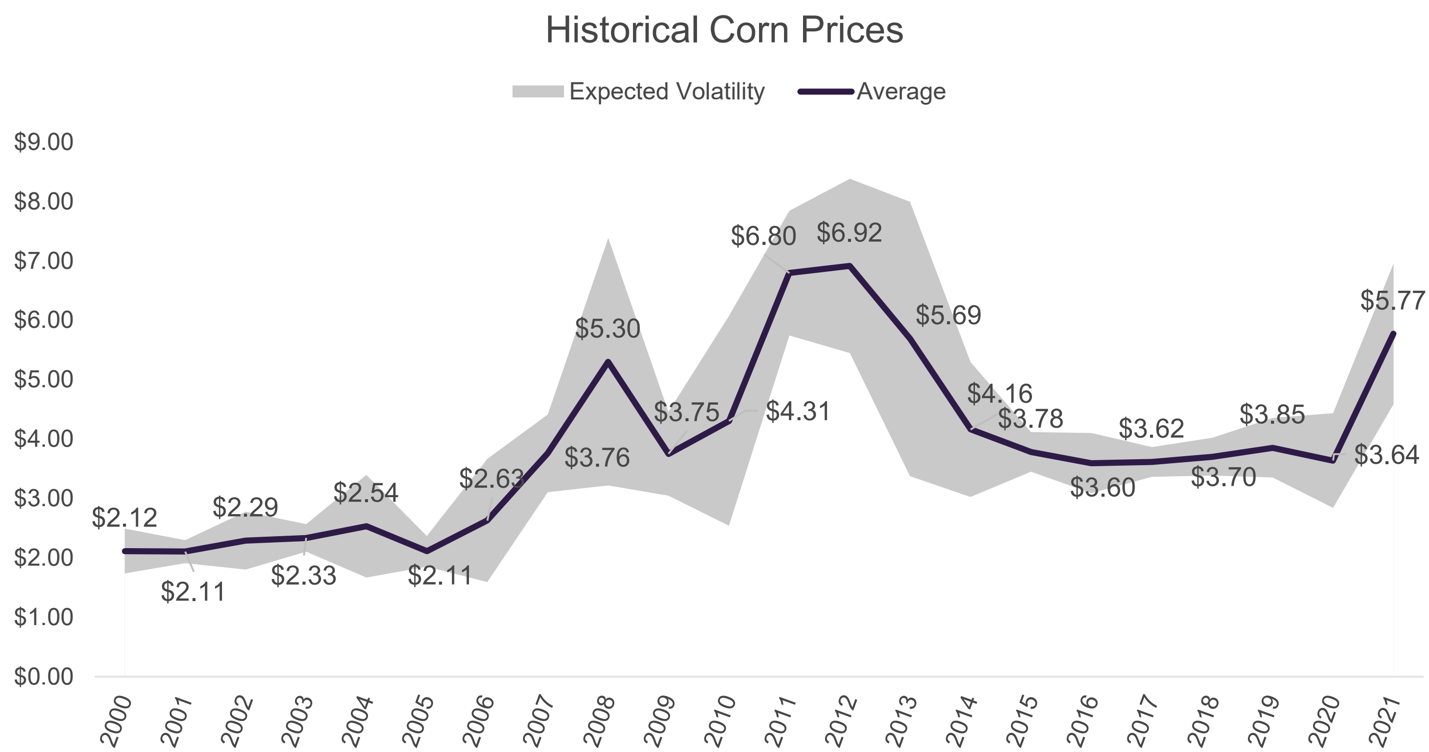
### A perspective on grain price volatility

In light of these elevated commodity prices, it's common to assume that markets will experience added volatility, but that's not historically been the case. Volatility within the market is not heavily correlated with the nominal value of the grain. We expect to see extreme volatility in response to uncontrollable factors, such as adverse weather events or trade restrictions, all of which will continue to characterize these markets. However, there has been a modest decline in market volatility in the last 10 years, which we will demonstrate using corn prices below (the same holds true for soybeans and cotton).




The takeaway is not about the relative volatility of these markets, but a reminder of the critical role that they play in allowing market participants to manage risks. Following multiple commodity price spikes that occurred in the 2008 – 2013 timeframe, producers sought to more aggressively manage these risks, which has led to more formal hedging and price protection programs amongst grain users. Fewer participants are relying solely on the spot market and are instead choosing to forward lock certain raw material or selling prices to remove risk. This had made commodity markets more efficient as a result of added liquidity and additional sources of price discovery.

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Sources: Macrotrends.net, Corn Prices - 59 Year Historical Chart;