

Middle Market

Food and Agribusiness



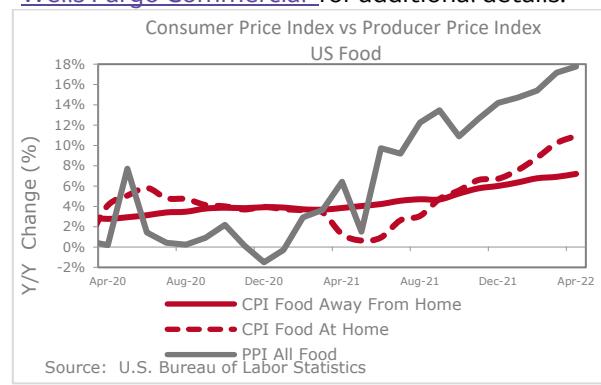
Food & Ag: What's happening

- Food security and the potential for food scarcity is garnering mainstream headlines.¹ This is a historically significant limelight for the global food value chain, particularly for highly globalized sectors. Supply chain disruptions are moderating but remain a point of risk for stakeholders.
- Food price inflation continues to drive public concerns; however, producer price increases continue to outpace consumer prices underscoring challenges for the food value chain. See CPI/PPI for U.S. Food graph.

Key Demand Developments:

- Real GDP in the U.S. declined on a quarterly basis in Q1-2022, the first quarterly decline since the pandemic-induced plunge registered in Q2-2020. Wells Fargo economists are noting that the contraction is in part, linked to the 6.9% rate of growth in Q1-2021. Real GDP growth is expected at 2.4% for 2022, while 2023 forecasts have cooled to 2.0%.

- Persistent inflation is contributing to the slowdown. While the May forecast maintained a slightly stronger pace of inflation throughout the forecast horizon, the Wells Fargo economists project that inflation is likely near peak and price pressures should abate somewhat over the remainder of the year.
- From food and agribusiness perspective, tightening labor markets will impact both operations and markets. Higher wages offset higher costs of living and support the likelihood that businesses can pass on rising input costs.
- For 2023, expectations of 5 more 25 bps rate hikes over the next two years are built into the economists' models, with fed funds rate peaking at 3.5%-3.75% range in Q2-2023.
- On the international front, Wells Fargo has revised the global GDP forecast to a below-trend pace of 2.8% for 2022. Lower U.S. and China GDP outlooks are driving this, with China's economic growth at 4.5% and risks still tilted to the downside.
- Fed tightening, safe-haven capital flows contribute to expectation of stronger U.S. dollar going forward.
- On all topics, see [Monthly Economic Outlook – Wells Fargo Commercial](#) for additional details.



¹ The Economist, week of May 16, 2022.

Food Highlights:

- **Pricing adjustments:** Many food manufacturers have implemented two to three price increases since 2021 and are likely to ask for another increase this summer. So long as the increases are consistent with the market they are being accepted but not without some dragging of feet and in the case of some discount retailers they are only agreeing to them near the “accept the increase or we don’t ship” deadline. Customers still need product since the consumer has yet to show much if any pullback of spending through April and early May.
- **Lack of precedence:** In some cases, contracts with long term customers were broken for the first time in their history due to the cost pressures. Many price reviews/increases that were historically on annual or 3-5 year review cycles have subsequently been renegotiated to a more frequent review process.²
- **Managing through cost inflation:** Margin pressure is likely to be a challenging theme for the foreseeable future. Those companies that were late/reluctant to increase prices in 2021 continue to re-visit whether tactical and even strategic adjustments are now necessary. One bright spot are reports that freight rates are softening which may be a reflection of better driver availability. Industry stakeholders are watching consumer spending closely as there is concern lower savings rates / account balances due to widespread inflation will begin changing purchasing behaviors in the 2nd half of '22.
- **Labor:** Industry sources are reporting that labor issues are improving regarding filling positions although labor rates remain a challenge.
- **Supply chain challenges persist:** Many branded food manufacturers are still experiencing scarce availability of certain raw materials and packaging materials. While these challenges are projected to moderate in H2-2022³, sector analysts continue to monitor risk of supply chain delays and manufacturing disruptions.

Beverage Highlights:

- **Alcohol:** Using on-premise beverage sales data as a barometer for return to normalcy, sales volume by dollar sales continues to post weekly increases, cited by Nielsen's BeverageTrak data.⁴ Post 2020 closures, the first signs of material on-premise return to growth trend occurred in May of 2021. A year later, weekly gains in overall sales continue to outpace the previous year.
- As the summer season emerges and food/fuel inflation remains historically high, it will be interesting to observe if the uplift from Mother's Day ushers in a normal seasonal on-premise sales for summer holidays.
- In 2021, Memorial Day was the biggest (by velocity measurements⁵) Monday of the year to date, and in turn, of the entire year. Upcoming 2022 Memorial Day should provide additional hindsight next month for 2022.
- **Non-alcohol:** Energy beverages, sports drinks, value-added and sparkling water, ready-to-drink coffee are pulling overall market share of the non-alcohol beverages from soft drinks, fruit juice, and even water.⁶ Marketshare comparison from 2018-2021 demonstrates this, see table below.

Non-Alcohol Beverage: Retail Marketshare	2018	2021
SOFT DRINKS	31.37%	30.59%
ENERGY BEVERAGES	14.43%	15.81%
WATER	11.84%	10.89%
SPORT DRINKS	7.14%	8.11%
FRUIT DRINK	7.88%	7.45%
FRUIT JUICE	7.48%	6.79%
LIQUID TEA	5.27%	4.72%
VALUE ADD WATER	3.54%	4.13%
SPARKLING WATER	2.88%	3.46%
RTD COFFEE	2.85%	3.23%

Source: Nielsen AOC incl Conv

² Wells Fargo sources

³ Wells Fargo U.S. Economic Outlook May 2022

⁴ ⁵ CGA, as of May 26 2022

⁶ Nielsen AOC incl Conv, as of April 2022

Commodity Highlights

- Grains and oilseeds:**

- Grain markets continue to trend higher as spring planting is well behind historical averages. Wet and cool weather has prevented planting throughout the corn belt. Spring wheat planting throughout the Dakotas has been the most impacted. Soybean acres are projected to be higher than corn acres for only the second time in history at well over 90 million acres.⁷ Corn usage is strong as ethanol production has been supported by high gasoline prices. These drivers are coupled with geopolitical issues and drought in South America.
- U.S. soybean usage in 2022 will continue to be strong as crush margins are high. Renewable diesel production is forecast to double over the next one to two years.⁸ The soy oil price has been exacerbated by global shortages of sunflower and palm oil.
- Wheat prices are strong due to dry weather throughout the Plains states and slow plantings of spring wheat. Ukraine and Russia have accounted for roughly 20% of world exports⁹. The supply chain is tight as demand for staple products such as bread, pasta and cereal have been high in the post pandemic economy.

- Dairy:**

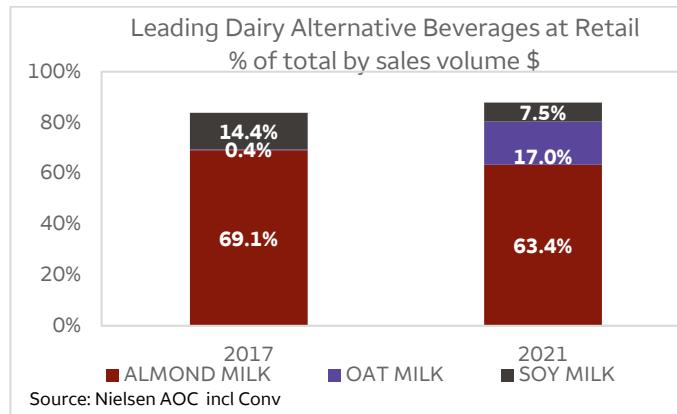
- All classes of milk have experienced price strength as the national dairy cow herd has decreased. This has been a result of high feed costs coupled with lack of labor. Cream supplies are tight which have resulted in higher butter and ice cream prices.
- The US continues to enjoy historically stronger exports of dairy as domestic prices are competitive on the world stage. Competition from New Zealand has decreased due to drought as well as a push to reduce herd size to lower greenhouse gas emissions. European production has also been reduced due to labor issues.
- The cheese industry is undergoing a large capacity expansion. Although cheese stocks are relatively high, domestic demand remains robust.
- The retail dairy case continues to be transformed by consumer preferences and interest in alternatives. According to Nielsen data, fluid milk alternatives continue to grow as a percentage of the total

beverage choices. As an example, alternative share of total beverages in the dairy case has grown to 16.7% in 2021 from 11.8% in 2017.

Sales Volume \$	2018	2019	2020	2021
Alternatives as % of total beverages in retail dairy case	13.4%	14.2%	15.2%	16.7%
Y/Y % growth Total Beverages	-4.2%	-0.4%	9.1%	-1.8%
Y/Y % Cows Milk	-1.3%	7.2%	-3.1%	

Source: Nielsen AOC incl Conv

- The dairy dept at retail enjoyed a revitalization associated with pandemic shopping, yet traditional fluid milk looks to be slipping back to pre-pandemic trends despite industry efforts at public education on nutritional benefits.



- Current trends are due in part to overall growth in this category, but it also remains a keen focus of traditional dairy players who are watching both more traffic to the dairy case and interest in non-dairy alternatives as both challenge and opportunity.

- Protein:**

- Highly Pathogenic Avian Influenza (HPAI) or bird flu has impacted nearly 38 million birds in the U.S.¹⁰ Table egg layers and turkey flocks have been impacted the hardest. This year's outbreak is the biggest for the poultry industry since 2015 as roughly 9% of the U.S. table egg layer flock has been impacted by HPAI¹¹. As a result, both egg and turkey prices have spiked higher.

⁷ USDA

⁸ US Energy Information Administration

⁹ FAS/USDA

¹⁰ APHIS / USDA

¹¹ APHIS / USDA

- **Seafood:**

- 2021 was a banner year for seafood due to consistently strong consumer demand coupled with supply chain issues and labor shortages which pushed prices for most products to all-time highs.¹²
- For the first quarter of 2022 seafood demand remains strong as restaurants/foodservice continues to open back up and supply remains somewhat constrained due to continued logistical issues and closure of Chinese ports due to COVID. However, a market correction is occurring in prices of certain products due to the increase in inflation coupled with lower consumer confidence. Products most impacted are the higher-value products like crab, lobster, and scallops. Prices for Pollock/Cod and Salmon continue to increase as demand shifts to these “middle of the road” items as disposable income declines due to wage increases not keeping up with inflation. Shrimp prices remain unsettled due to current over-supply from both domestic sources and imports.¹³

- **Sugar:**

- Sugar supplies have tightened for the rest of the 2021/22 marketing year (which ends in September 2022) due to lower sugar production from current beet crop and delay in planting current beet crop due to weather which reduces the projected early harvest sugar supply for the current crop year and pushes it to 2022/23 crop year. As a result, cash sugar market remains highly unsettled as users are scrambling to replace lost sugar deliveries and are being forced to purchase higher priced cane sugar from refiners or sugar from distributors at prices estimated at 30-50% higher than planned.
- Strong demand for sugar deliveries for food use continue. The May WASDE report lowered from April its forecast for 2021/22 sugar production and raised deliveries; however, both were more than offset by sharply higher projected imports resulting in an increase in the Stock-to-Use ratio to 14.4% from 12.5% for April and March’s 13.8%.¹⁴ Projected imports were increased by 411,000 tons due to combination of increases in the tariff rate quota program, other sugar imports, sugar, imports from Mexico, and an increase in high tier import quotas.
- Mexico’s sugar production (May) is projected up 4% Y/Y. Domestic use is projected at 4.4mm tonnes with

exports of 1.94mm tonnes. Total October-March U.S. imports of sugar from Mexico were estimated at 471.8mm tonnes, up 59% from same period last year and equal to 50% of projected imports for the year.¹⁵

- **Permanent crops: Tree Nuts and Wine Grapes**

- The initial 2022 California Almond Forecast¹⁶ posted expectations of -8% Y/Y yield vs. 2021. Record bearing acres at 1.37m, substantial non-bearing acres (320k), and moderating prices may challenge decisionmakers to remove marginal orchards.
- YTD pistachio shipments have been showing material improvements to delays that were experienced in late 2021 and early 2022. YTD export shipments are now 9%Y/Y greater than the previous year, while domestic shipments continue to outpace last year at approximately 9% Y/Y as well.¹⁷
- The California Walnut Acreage report came out in late May, reporting slightly higher grower returns (up 17% Y/Y) on less total production (-8% Y/Y) for 2021. The last five years’ average grower return per acre has been nearly -45% less than the best years of 2010-2014. YTD walnut shipments are down -24.46% Y/Y for domestic destinations, and down -1.70% Y/Y for export totals¹⁸.
- Continued drought impacting water deliveries and declining groundwater access as SGMA unfolds continue to be top concerns for tree nut growers.
- Vineyards throughout California and the Pacific Northwest saw the first signs of budbreak in March. On April 12th vineyards in the Sierra Foothills were hit with frost. While overall damage estimates remain speculative to an extent, growers in Amador, El Dorado and Calaveras counties have applied for disaster relief. Other growing regions in California continue to monitor crop to assess potential frost damage, with most stating while yields may be down the losses will be “spotty” and will not reach disaster-aid levels.
- The CA bulk market, however, is not yet seeing the impact of the anticipated lower yields as most producers and growers are still assessing in key regions and balancing production needs in an environment of relatively flat sales.
- Oregon’s famed Willamette Valley has also recorded frost damage from the April 14th and 15th drop in

¹² Urner Barry’s Reporter Spring 2022

¹³ Urner Barry’s Reporter Spring 2022

¹⁴ USDA’s May 12th Sugar & Sweeteners Outlook

¹⁵ USDA’s May 12th Sugar & Sweeteners Outlook

¹⁶ USDA NASS May 12 2022

¹⁷ Administrative Committee for Pistachios April 2022

¹⁸ California Walnut Board as of May 10 2022

temperatures. While still too early in the region's growing season to access damage, any impact is anticipated to be widespread throughout Willamette and Columbia Valley.

- Fresh produce:**

- Crop transition is underway in the berry market as Mexican crops are winding down with California and other growing regions coming online. Berry prices may stay elevated as California supply hits the market.¹⁶
- Weather continues to be a topic of discussion as it impacts crops across the country with unusual heat in the southwest, late season snow in the northeast, and rains in Florida. Florida tomato season is wrapping up early under pressure from lighter supply.¹⁹
- California avocado season is reaching peak supply and will continue through June. Both Peru and Columbia have been supplying the U.S. as well. Demand remains strong and Mexican imports also fulfill the increased demand.¹⁶

- Forest products:**

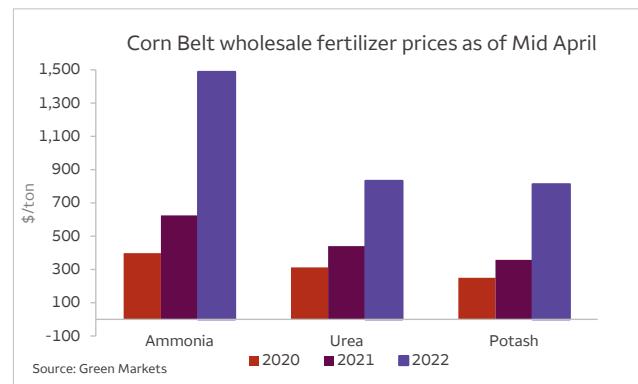
- Softwood lumber prices remain highly unpredictable. The price surge in 1Q2022 reached the second highest peak all time. Prices have since begun to fall rapidly, but how far down prices will fall is anyone's guess. The future direction is unclear. Nonetheless, 2Q22 earnings for most softwood lumber producers should be very strong.
- Structural Panel prices have followed a pattern mirroring that of softwood lumber prices – a peak in 1Q22 followed by a downturn.
- Hardwood lumber prices remain strong in 2Q22, coming off a steady gain over the course of most of 2021. The past year was by far the most profitable in the past several for hardwood lumber producers.
- North American pulp prices for most major grades such as NBSK and Fluff have surged in the last two months to nominal record highs²⁰. The current price for bellwether NBSK is roughly 50% higher than two years ago.²¹ However, forecasts are for price declines in most grades.

- Crop inputs:**

- Fertilizer prices are showing signs of topping out with some regional price reductions as planting season winds down. Tampa Ammonia is over \$300/mt lower

for June, West Coast urea has dropped over \$100/mt and NOLA UAN market topped out at \$630/mt.²²

- In a reflection of the higher prices there have been indications of reduced fertilizer usage in terms of P and K, in addition to more variable rate technology for precise applications
- While prices are softening, there remains support based on high grain prices (corn still over \$7/bu.), elevated fuel prices continuing to limit fertilizer production in Europe, and the unknown of the Russia-Ukrainian conflict impacting up to 33% of key nutrients²³.
- Key Ag Chemicals such as glyphosate remain in short supply influencing cropping mix in addition to alternative products to control weeds.
- Cooler spring weather has Increased levels of seed treatments to protect the higher priced varieties and help with germination.



- U.S. ethanol production increased 2.3% during the week ending May 20. Production is essentially the same as last year currently. Ethanol stocks declined a negligible amount to hold steady at 23.7 million barrels (23 days of supply). Producer margins were estimated to average \$0.38/gallon last week according to Iowa State data.

- Imports**

- The latest outlook for total production in coffee year 2021/22 remains unchanged at 167.2 million bags, a 2.1% decrease compared to last year. Pricing appears stable above the \$2.00 mark but can swing with more drought and weather effects in Brazil.²¹

¹⁹ FreshPlaza

²⁰ Fastmarkets RISI

²¹ RandomLengths

²² Green Markets

²³ USDA ERS

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