

Middle Market

Food and Agribusiness



Food and Ag: What's happening

- Food prices may be hovering near the 'peak', as consumers shift-to-value impacts demand and core inflation as measured by consumer price index (CPI) slows
- Markets and end-users are eagerly consuming seasonal US corn/soy crop estimates as various tours of grain-producing region wrap. Estimates are pointing towards corn yields lower than historical expectations due to weather conditions, while soy yield estimates remain cautiously optimistic
- The Inflation Reduction Act focuses on promoting the production/consumption of clean energy with roughly \$500 billion in new spending offset by \$800 billion in new tax increases/spending cuts. This ushers in more policy to curb climate change; agribusiness is paying keen attention regarding oversight of natural resources (water, air, land) and tailwinds to regenerative ag and carbon credit opportunities

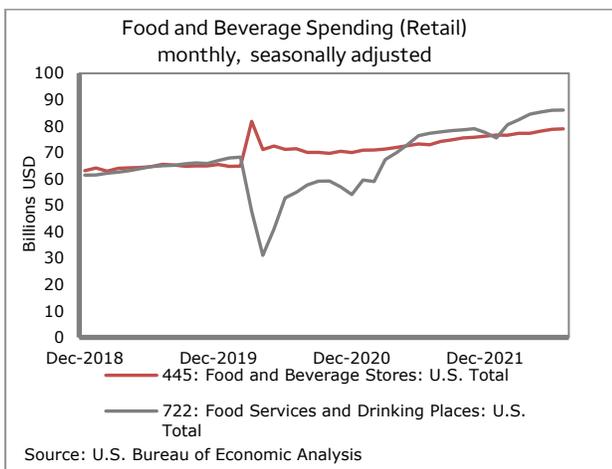
Food Highlights:

- Highlighted in last month's edition, quarterly unit sales for retail departments appear dampened by higher prices. In total, quarterly unit prices grew 9.7%Y/Y while unit sales dropped -1.9%Y/Y.¹

Key Demand Developments:

- Wells Fargo economists point to the strength of the labor market as counterpoint to whether the U.S. economy is already in recession. Employers added 1.2 million jobs in Q2 and over half a million jobs in July.²
- Core inflation increased 0.3% in July, but the past three months is still at 6.8% annualized pace. Per Wells Fargo economists, the -7.7% July decline in gasoline prices was significant, yet core inflation continues to run well over the Fed's 2.0% target. A mild recession is still in the forecast along with aggressive Fed tightening.
- Slower-than-expected inflation data for July is signaling some reprieve in overall price pressures. Household spending increased in five of the past six months, despite incomes not keeping pace with inflation. While this is not sustainable, until demand moderates, increases in the fed funds rate is expected to continue through end of the 2022. If inflation eases and unemployment rates reverse, the Fed could begin *cutting* rates in the second half of 2023.
- Overall core consumer price index is only the big picture. With the monthly energy category price decline the most significant since June 2020, increases in food, housing, and other services categories continue to have outsize impact of the total. The CPI for both Food-Away-from-Home and Food-At-Home remain at historically high levels, at 7.6%Y/Y and 13.1% Y/Y, respectively. Whether these individual price increases are enough to accommodate historic range of 16-17% Y/Y All Foods Producer Price Index is dependent on the details of sector and market position. The relief seen in the June All Foods PPI was erased with another 1.0% M/M increase in July.
- The global international outlook expected to experience earlier and more pronounced recession than in the U.S. The global GDP forecast is revised to 2.3% for 2022, slowing to 1.6% in 2023.
- Regarding currency values, strength of the U.S. dollar is expected through 2022 and early 2023. A shorter and sharper Federal Reserve rate hike cycle and a U.S. recession reinforce the case for the dollar's peak in Q1-2023. On all topics, see [Monthly Economic Outlook – Wells Fargo Commercial](#) for additional details.

- The monthly Consumer Confidence survey³ revealed a decline for a third consecutive month in July, rooted in concerns about rising gas and food prices. The focus then shifts to the details underlying changes in customer behavior and tracking demographics. Middle and higher income customers are seeking more value, increasing spending at value-oriented retail channels. Beginning in mid-June through July, Walmart Grocery reported a significant acceleration of buy rates of households with over 100k annual income.
- This ‘flight to value’ is impacting forward-plans for food manufacturers. Brand loyalty is being tested if differentiation does not pass the substitute test, and private label and value brands are recognizing the opportunity to gain dollar share in this environment.
- Food Manufacturers are also focusing efforts on providing for the growth in food-away-from-home category. Overall food and beverage spending continues to grow, per the Bureau of Economic Analysis, with spending at on-premise food/drink establishments continuing to recover strongly (since May 2021) and outpacing retail expenditures by historical spreads. See below.



Beverage Highlights:

- **Alcohol:** On-premise alcohol beverage sales continue to post velocity increases of approx. 7% versus 2021. Drivers of these trends include check value up 9% Y/Y, with ticket count slightly down at -2.0% Y/Y⁴.
- Industry players are optimistically anticipating Labor Day activity; if past trends hold, 2022 Labor Day weekend performance will be driven by traffic and

check value increases. With lower fuel prices, Labor Day travel for 2022 and spending may have a lift.

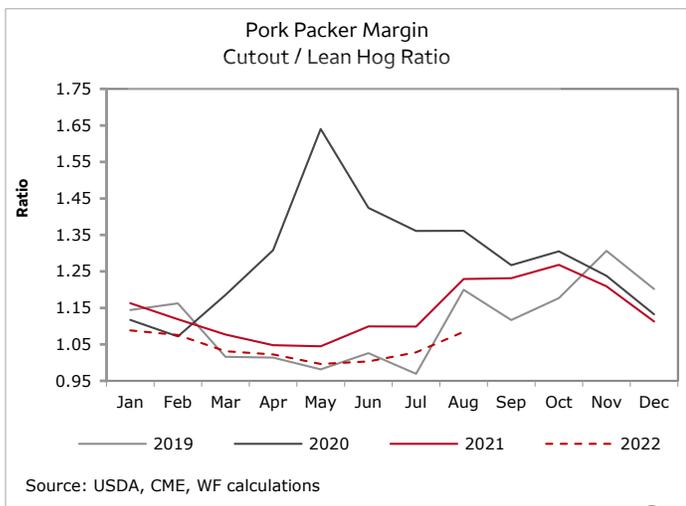
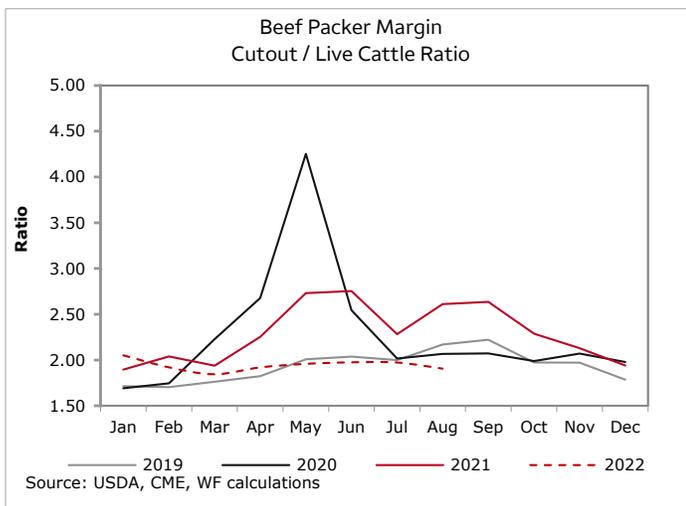
- Analysts are working on normalizing the unusual activity of pandemic by stacking the growth rates and evaluating absolute dollar gains. By absolute dollar gains, alcohol beverages (Beer/FMB/Cider) at retail are amongst the top for ‘growth super-categories’, according to Nielsen, including non-alcoholic beverages, fresh meat, and salty snacks. All of which are likely to get additional lift from the last big warm weather three-day weekend.
- **Non-alcohol:** As the anomalies of the pandemic era are ironed out, overall growth in non-alcoholic beverages at retail gained over \$23.1 billion versus the 2019 period, according to Nielsen. Top performers remain soft drinks, energy beverages, sport drinks, and water. As of late July, underperformers versus a year ago, measured by absolute dollar loss/gain include fruit/veg blends, and ready-to-drink chai tea.

Commodity Highlights

- **Grains and oilseeds:** Corn markets have gained strength as late summer heat and dryness have hindered the crop throughout August. Soybean crop conditions have held steady as it is later maturing than corn.
- Wheat prices have surged higher as the spring wheat harvest in the Northern states has been below expectations. Protein content, a key component of milling usage, has been above average as dry conditions increase protein levels.
- U.S. soybean usage in 2022 will continue to be strong as more biorefineries come into production. Renewable diesel production is forecast to double over the next one to two years. The soy oil price has been exasperated by global shortages of sunflower and palm oil as a result of the Ukraine situation.
- **Dairy:** Milk prices are moving lower. The Class III price peaked in May at \$25.21 and fell to \$22.52 in August.⁵ Higher milk production and a slowing economy decreased domestic demand. Additionally, inflation and a slower economy have reduced restaurant demand softening cheese and butter sales.
- Higher dairy exports have aided milk prices. January through June volume was 17% higher than last year. June cheese exports were up 23% and butter 63%.⁶ Lower milk production in Western Europe, New Zealand

and Australia have kept U.S. prices competitive on the world market.

- The cheese industry is undergoing a large capacity expansion as demand continues to increase. The 40-pound cheddar block price has hovered around \$2 per pound. Cheddar is moving in a similar range. The dry whey price has been moving lower. It averaged \$0.53 per pound for May and is trading at \$0.45.⁷
- Milk prices are likely to average lower in 2023. The level of milk production, domestic sales and dairy exports will combine to move prices off the recent highs. With the increase in per-cow yields in FY2022, milk production is forecasted to continue to trend higher into next year. Exports to China have been lower after reaching historical highs earlier this year.
- **Protein:** Two new beef packing plants were announced this summer, joining a growing list of planned beef plant expansions and new plants.



Source:

- Packer margin ratios for both beef and pork packers continued to track well below 2021 levels due to softer cutout values and higher animal prices. The August ratio is showing improvement for pork packers.
- After spiking to record high levels in late July, wholesale egg prices experienced a sharp pullback in mid-August. It is too early to speculate on a top in prices, but a rebound in the laying flock number in July indicates the egg industry is beginning to recover from this Spring's Highly Pathogenic Avian Influenza outbreak. Potential impact from the recent H1N1 cases in Northern California is too early to assess at this point.
- CPI data from July for Meats, Poultry, and Fish (MPF) showed slowing month-to-month inflation. July data was 0.4% higher than June data. Beef and Fish both saw a monthly decline in prices, while pork and poultry climbed higher. Year-over year CPI data for MPF is still very high with July '22 data 9.3% higher than July '21.
- **Seafood:** The current economic environment is decidedly different compared to last year. The pent-up demand for travel, excess savings, and government money that we saw in 2021 has evaporated. Unlike last summer, when demand for seafood products was insatiable, current inflationary pressures in the form of rising costs and interest rates coupled with lower consumer confidence have many consumers looking for lower cost alternatives for the higher-value seafood items like lobster, crab, & scallops.
- Since the beginning of 2022, crab, lobster tails, and scallop prices have all experienced the most rapid and steepest wholesale market price declines in recent history. This is primarily due to a drop in demand from food service and retail outlets as they try to sell through current high-priced inventory without taking a loss before "re-stocking"; all of which has driven current retail demand for these products down significantly.
- Shrimp and Salmon prices, however, have not been impacted by this issue as these markets are much more global and producers can somewhat adjust production level when they see demand changes in the market.
- If current YTD trends hold, U.S. shrimp imports should set a ninth-straight record as volume through 06/22 is 9.2% higher than prior YTD.⁸

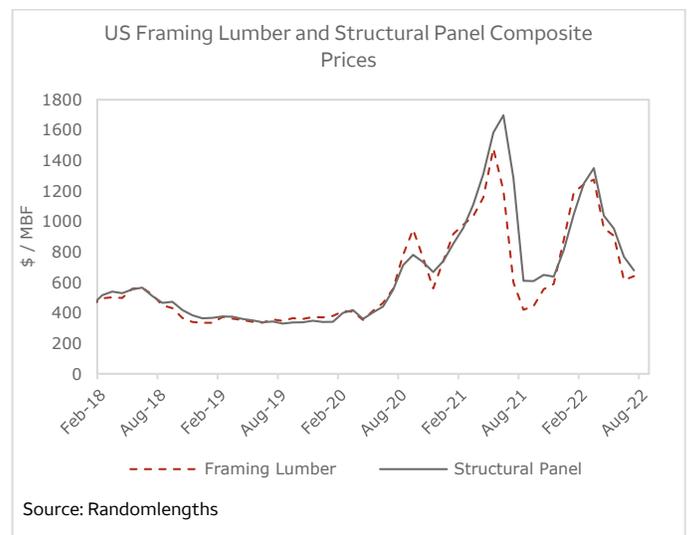
Permanent crops: Tree Nuts: The almond marketing year finalized as of 7/31, and handlers will be dealing with record carry-over this season, now estimated at 837.8m lbs.⁹ While sellers are motivated, industry sources report that buyers' interest is limited, partially in waiting for new crop and harvest data to emerge.

California harvest is in full swing, with reports of smaller nuts, and some quality issues, depending on early season regional frost damage and reports of well-vs-ditch water quality issues impacting tree health.

- Pistachio shipments rebounded from container delays and port issues, especially from February onward. With one more month in the marketing year, 21/22 is expected to be a record year for total shipments, with industry closely watching August results. As of July, domestic shipments are up 7.5%Y/Y, while exports are up 20% Y/Y.¹⁰ Pistachio harvest will be in full swing within the upcoming month, and new crop production and carryover will weigh heavily on the market pricing.
- **Citrus:** After a short crop in 2021, down 35%¹¹, California citrus production appears to be back on track as an average crop for 2022. With growers able to control the flow of product by leaving fruit on trees, the citrus market should provide ample inventory to meet demand.¹²
- Sen. Marco Rubio of Florida is appealing and requesting a hearing for the bill entitled Defending Domestic Orange Juice Protection Act. According to “The Packer”, supporting this bill’s progress through the Senate is important to support the ability for producers to continue to use Florida Orange Juice branding. With current USDA requirements, Florida processors may need to import product from Brazil to reach BRIX requirements imposed by the USDA. Without passage of the bill, this change would make the product ineligible to brand as Florida Orange Juice.
- **Fresh produce:** Organic produce has experienced reduced consumer demand as the costs continue to rise when compared to conventional produce. Inputs and amendments to grow organic crops are much more expensive and consumers have shifted some spend to conventional crops due to inflationary price pressures.
- The blueberry crop in the Pacific Northwest is beginning harvest with increased supply from additional bearing acreage. Blueberry deals are expected at the retail level as the crop begins to hit store shelves.
- **Forest Products:** Softwood lumber prices have been trading within a much narrower range over the past three months after the steep decline in 2Q22. Near-term price changes remain unpredictable, and September lumber futures are trading close to today’s cash price. There is a sizable discount for the November contract, indicating that lumber traders expect further

price cuts. 3Q22 earnings remain good for most producers.

- Structural Panel prices similarly have found some footing in 3Q22 after a significant price correction. Most plywood prices remain profitable but bellwether OSB prices, although still profitable, are roughly on par with year-ago trough prices.¹³
- Hardwood lumber prices are declining in several major species and grades as increased summer production overtops diminishing demand. Industrial hardwood lumber products such as railroad ties and pallet stock are still priced favorably.
- North American pulp prices remain strong. Prices have been holding in several major pulp and paper grades, and fluff pulp is trading at record levels, up 100% YTD¹⁴ in 2022. On the other hand, economic headwinds could eventually take the wind out of the sails for this broad industry segment. Announced future price increases may not be accepted at this juncture.



Crop inputs:

- A power crisis in China’s Sichuan province has forced some fertilizer companies to stop production, according to Bloomberg. Two of the largest companies are suspending operations for about a week. Temperatures in Sichuan have soared over 104 degrees in some areas, pushing up air-conditioning demand and drying up reservoirs behind hydro dams.
- European natural gas futures extended their gains to a record-high settlement on Aug. 18, according to Bloomberg, as an energy-supply crunch continued to batter the region amid signs that the fuel is becoming too costly for industrial use and power generation. This has become the focal point of the global urea complex for the 2nd half of the year.

- USDA Crop Progress report on August 22 reflected the negative sentiment of the Crop Tour, as the USDA lowered their corn and condition ratings slightly during a week that traders expected ratings to remain unchanged following widespread rain and moderate temperatures last week. The USDA cut the U.S. corn condition rating 2 points to 55% good to excellent, which is 7 points off the 62% five-year average. Bean condition was cut 1 point to 57% good to excellent, below the 61% five-year average.
- Issues with the chemical Dicamba is making headlines. In draft risk assessments, the Environmental Protection Agency (EPA) said that “despite the new control measures,” it received nearly 3,500 incident reports in 2021 of damage to crops that were not genetically engineered to tolerate the chemical and to “non-target plants in non-crop areas.”
- U.S. ethanol production during the week ending August 12 declined 3.8% to 983,000 barrels per day, which is slightly larger than a year ago. Ethanol stocks increased slightly during the week to 23.45 million barrels (24.5 days of supply). Corn used for ethanol during the week was estimated at 99.8 million bushels, bringing the marketing year total to 5.14 billion bushels.¹⁵ At the current pace, total corn use for ethanol will meet the USDA’s 5.375-billion-bushel annual target. Ethanol producer margins were estimated at \$0.15/gallon last week according to ISU CARD data below.

August WASDE report. Texas leads the production decline due to severe drought conditions causing high crop abandonment and lower yields.

- **Sugar:** The USDA in its August 12th Crop Production report issued its first sugar production forecasts for both beet and cane producers. Sugar beet production for 2022 is projected to decrease 3.3mm tons (9%) Y/Y to 33.5mm tons while sugar cane production if forecast up 2.5% to 33.7mm tons¹⁶
- At the same time, in its August 12th WASDE report, the USDA forecast 2022/23 beet production up 4.1% over 2021/22, cane production unchanged and total sugar production up 2.3%. This increase in the WASDE beet sugar production was based on higher average yield forecast in the NASS crop production report. Total sugar supply forecasts increased due to combination of change in beet sugar production and a 47,000 ton increase in high-tier imports to a record 325,000 tons resulting in an increase in the stocks-to-use ratio from 14.0% to 4.3% for 2022/23.
- In general, beet crops continue to improve from earlier in the season, especially in Montana and the Red River Valley. Further, cooperatives in two of the major growing regions plan to delay harvest from 1-3 weeks to give late planted crops more time to deposit sugar.¹⁷



- **Specialty crops:** Hay prices on the West Coast continue to be firm, but demand is seeing some softening from export buyers. Forced water allocation reductions from lower Lake Mead levels will impact growers in Arizona, Nevada, and New Mexico.
- The U.S. cotton crop harvest is expected to be the smallest crop in 13 years according to the most recent

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¹ Nielsen Consumer LLC, Retail Measurement Services 7/222

² US Dept of Labor and Wells Fargo

³ Toluna July 2022

⁴ CGA Beveragetrak 7/8/22

⁵ CME

⁶ CME

⁷ CME

⁸ Urner Barry 08/18/2022

⁹ California Almond Board

¹⁰ Pistachio Administrative Committee

¹¹ Fresh Plaza

¹² The Packer

¹³ RandomLengths

¹⁴ Fastmarkets RISI

¹⁵ Iowa State CARD

¹⁶ USDA NASS

¹⁷ Sosland Sweetener Report

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