



# Q1 2023 Industry Update

## Wells Fargo Agri-Food Institute

### Economic Developments

Wells Fargo Economists predict the Federal Market Open Committee (FOMC) will hike the federal funds rate by 25 bps at its February meeting followed by two more 25 bps rate increases at the March and May meetings. These moves by the FOMC would put the federal funds rate at 5.00-5.25% by the second quarter of the year. The target inflation rate of 2% remains out of sight with ongoing strengths of labor costs. A drop in gasoline and natural gas prices point to a lower inflation rate but with the high-income wages and consumer expenditures, inflation will remain higher than the targeted rate. Projected personal consumption expenditures in 2023 are slightly higher than originally projected due to strong income growth. The unemployment rate fell to 3.5% while hourly wages continued to rise, although this is expected to ease in second half of 2023.<sup>1</sup>

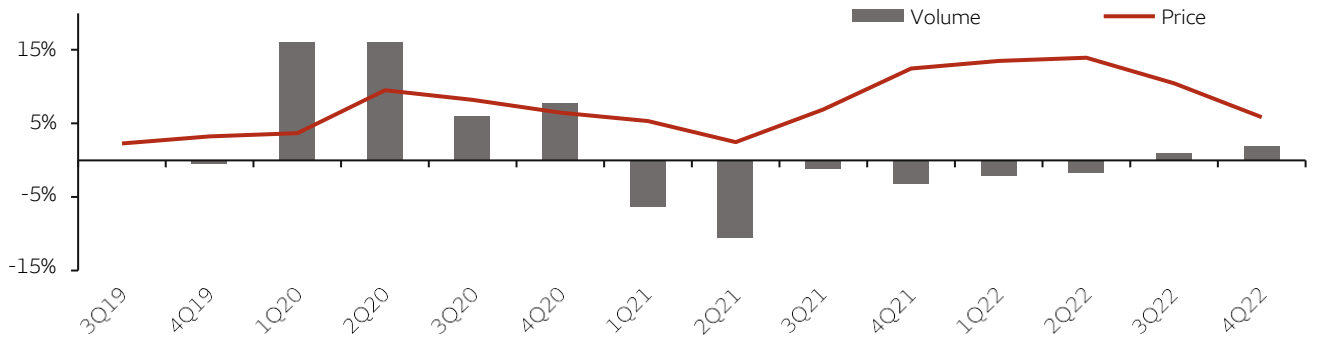
### Impactful Agri-Food Industry Happenings

- Food and agriculture stakeholders are tracking the drivers of cost inflation, including a combination of competing or scarce products, resource disruptions, or regulatory pressures.
- Year-end 2022 bioenergy statistics<sup>2</sup> reveal the highest average annual diesel prices since 2013, and a 52% YOY increase since 2021. Renewable diesel hit an all-time high both by domestic production and consumption in 2022. Consumption of fuel ethanol and gasoline fell -33% YOY. Stations offering alternative fuels jumped nearly 10% YOY for 2022 including compressed natural gas, electric, hydrogen, liquefied natural gas, liquefied petroleum gas, M85, and propane.
- The U.S. Supreme Court is expected to have a final decision on the critical Waters of the U.S. (WOTUS) case this year. Meanwhile, 17 farm advocacy groups, including the American Farm Bureau, have filed a lawsuit challenging the EPA's final definition of WOTUS which extends Federal protection to large waterways, such as interstate rivers and streams, and adjacent wetlands.<sup>3</sup> Opponents point to the continued financial burden for farmers to both comply and respond to litigation, while Environmental Social Governance (ESG) gains momentum as a strategic focus and investment across the food and ag value chain.
- Food insecurity continues to attract attention internationally, exacerbated by the Ukrainian/Russian conflict, commodity prices, and trade issues. According to the ERS, the number of food-insecure people in 2022 is estimated at 1.3 billion, a 10% YOY increase from 2021. These metrics impact sovereign policy and trade negotiations.
- The reopening of China after months of severe Covid-related restrictions is raising expectations of demand-related international inflation, particularly for commodities and energy.<sup>4</sup>

# Food highlights

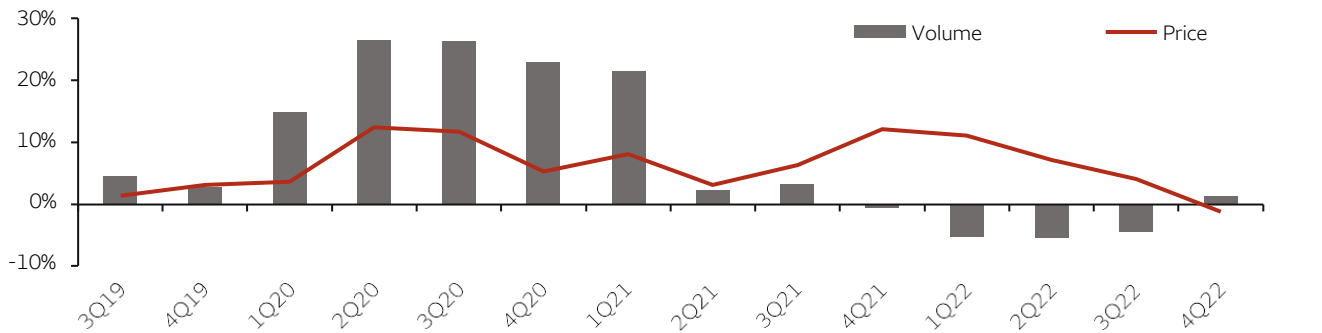
- Year-end retail department trends show YOY volume declines against a backdrop of 15% YOY price increases. The dry grocery, dairy, frozen foods, and bakery departments all show a stagnant or very slight negative volume versus last year. The exceptions are noteworthy, however, as price increases in fresh item departments including meat, seafood, and fresh produce appear to have peaked, signaling the moderation in food price inflation that economists have been expecting.

## Meat



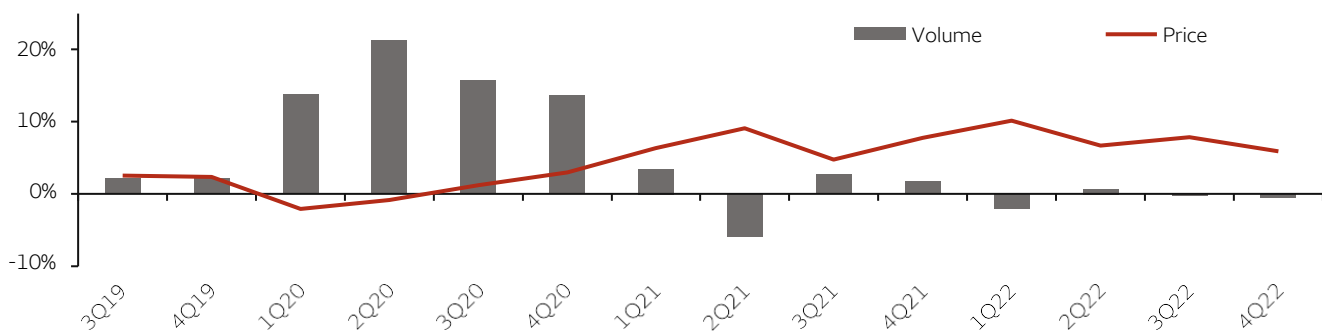
Source: Nielsen IQ 1/2023

## Seafood



Source: Nielsen IQ 1/2023

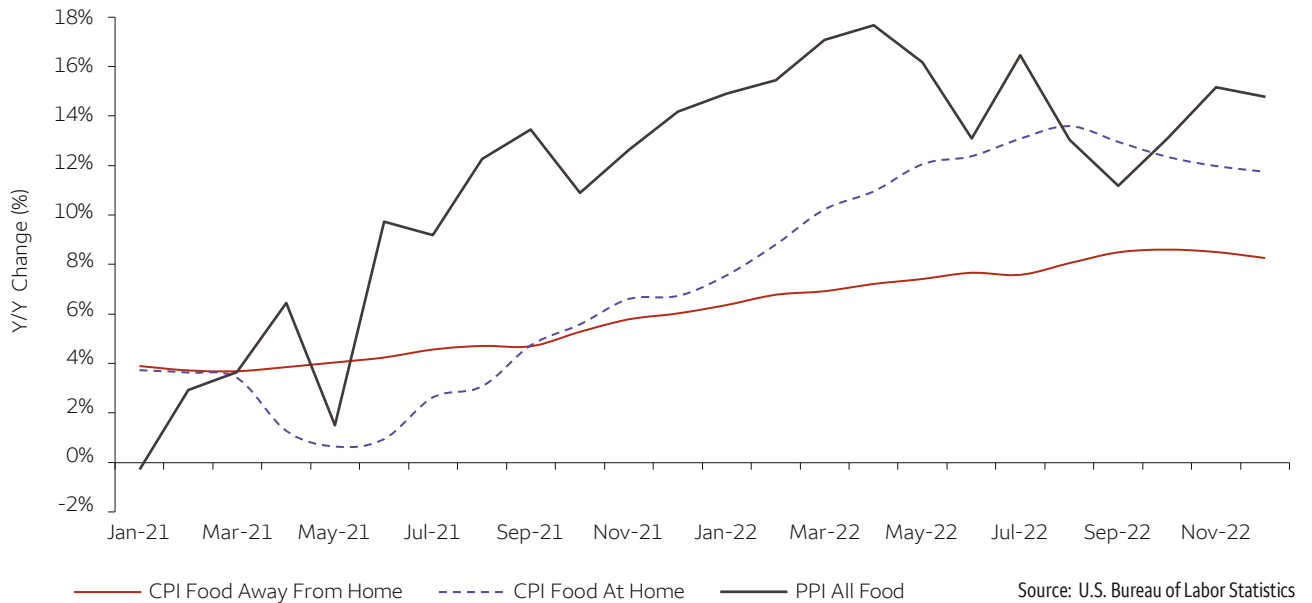
## Fresh Produce



Source: Nielsen IQ 1/2023

- The all-food Producer Price Index (PPI) is trending lower from the highs of one year ago. The graph below shows that cost inflation remains a burden for food producers. The Consumer Price Index (CPI) has begun to soften, yet food prices at retail persistently higher YOY growth levels than food prices away from home. For food producers this may be the sign that the opportunity to pass along costs is waning, and another demonstration (like retail department volume growth) that the inflationary environment continues to impact consumers' purchase decisions.

### Consumer Price Index vs Producer Price Index, U.S. Food



- Demographic shifts and recessionary pressures are weighting the omnichannel watchers towards additional brick and mortar. While the pandemic lifted e-grocery platform development and sales, it turns out that new dollar stores are driving Coresight Research's 2 to 1 store openings vs. closings. Of particular interest to food manufacturers is that dollar and discount formats are offering a 'just-in-time' and value-oriented grocery items to communities and neighborhoods, and serving an aging population concerned about health expenses, price-conscious buyers, and growing wealth disparity. NielsenIQ has tracked the dollar store YOY growth outpacing all others for several years. The mass merchandisers have been closing and/or consolidating stores for several years. Not surprisingly, convenience stores still lead all categories by nearly three-times the count of all others.



# Beverage highlights

- Dry January is evolving. The balance between the so-called ‘moderation movement’ and creative mixology is drawing attention to more detailed market segmentation for beverage brands. According to the Food Institute, long term trends in health and wellness are changing consumption dynamics. Veylinx reports that more than 75% of Americans report that they’ve given up alcohol for at least a month in the past, not just part of the Dry January idea. Nearly half of drinkers are trying to reduce consumption. 52% of these same drinkers respond that non-alcoholic beverages are now part of their regular routine.
- Non-alcoholic options are the only segments in the Beer and FMB/Cooler categories that posted YOY growth for 2022. That said, non-alcoholic volumes remain at only a fraction (less than 2%) of the overall market. All of this against backdrop of rising prices across the board. Beer prices increased another 4.7% YOY in 2022, while FMB/Ciders’ prices grew 5.2% YOY overall.
- 2022 wasn’t kind to the hard seltzer segment. With nearly 17% YOY drop in overall sales volume, that segment is consolidating several brands with strong segmentation.
- For non-alcoholic beverages, the annual top-ten shows some notable slow-downs in growth. Energy beverages maintains its number two position to soft drinks, and above the water category, but overall sales dollar growth is slowing a bit from nearly 15% YOY last year to 9.4% YOY growth in 2022. Sports drinks growth also slowed from nearly 18% YOY growth last year to 12% growth in 2022. The increase in fruit-based drinks leads the analyst to be looking for immunity-health seekers to replace other types of sugars. See below for 2022 market share and annual YOY sales growth.

## Beverages at retail, top ten by type

(Sales volume in \$, % YOY)	2022 market share	2019	2020	2021	2022
Non-alcoholic beverages		4.1	9.7	10.1	10.9
Soft drinks	32%	2.8	10.5	8.2	13.4
Energy beverages	15%	11.8	7.3	14.7	9.4
Water	11%	2.4	3.5	9.4	15.8
Sport drinks	8%	6.7	13.8	17.6	12.2
Fruit drink	7%	1.0	9.6	7.3	10.0
Fruit juice	6%	-1.8	13.7	1.9	4.8
Liquid tea	5%	0.4	6.6	5.7	7.3
Value add water	4%	10.6	7.4	22.1	11.4
Sparkling water	3%	12.0	22.7	9.6	6.2
RTD coffee	3%	2.7	15.4	20.2	8.3

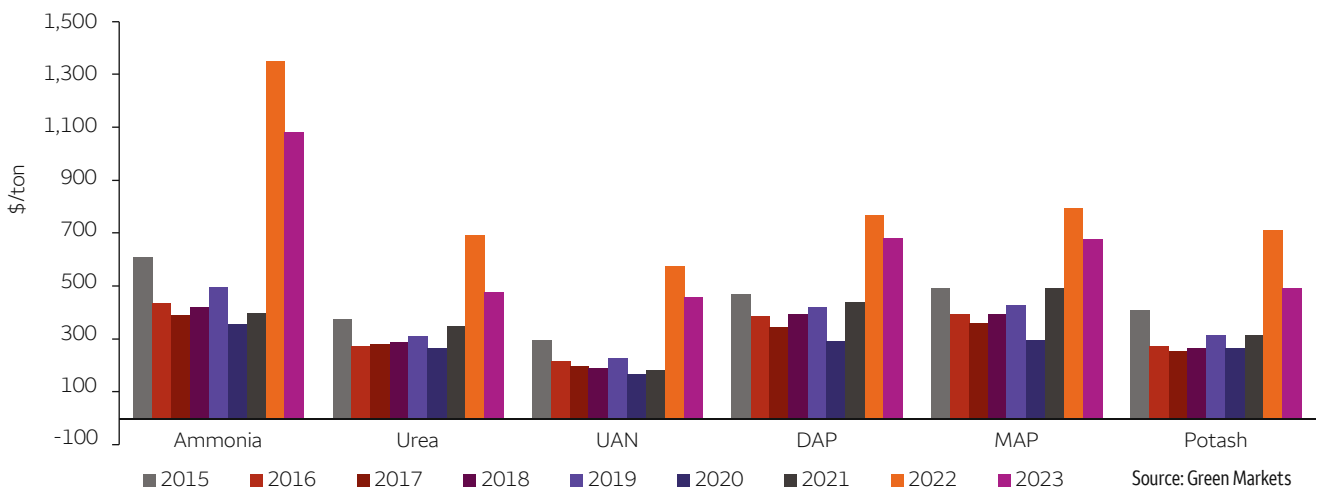
Source: Nielsen IQ

# Commodity highlights

## Crop Inputs

- U.S. Department of Agriculture (USDA) on Jan. 9 announced that it will soon begin accepting public comments on environmental and related aspects of 21 potentially viable projects to increase fertilizer production across the US totaling up to \$88 million. These applicants have requested grant funding through the first round of USDA's newly established Fertilizer Production Expansion Program. The \$500 million program was announced last year. The maximum award is \$100 million. The minimum award is \$1 million. The grant term is five years.<sup>5</sup>
- The natural gas situation has completely reversed with extremely warm weather in Europe and the U.S. (outside of Christmas) and prices reaching the lowest level in nearly a year. In Europe, prices on the benchmark Dutch futures contract are down almost 80% since August while United States natural gas is about 60% off its high. This has no doubt helped to ease production concerns and pushed ammonia producers to restart plants that were shuttered back in the summer.<sup>6</sup>

**Corn Belt Wholesale Fertilizer Prices as of Mid January**



- U.S. ethanol production during the week ending January 6 rebounded nearly 12% from the prior week to 943,000 barrels. This is 6% below last year. Ethanol stocks declined 3% last week to 24 million barrels (22 days of supply). Production was 4% larger than one year ago. Corn used for ethanol was estimated at 95 million bushels. This is below the weekly average of 102.5 million bushels of corn needed to reach 5.275-billion-bushel USDA annual forecast. Ethanol producer margins averaged \$0.36/gallon last week.<sup>7</sup>
- According to Scott Beck, President of Beck's Superior Hybrids, "seed is an input that delivers high value as a percentage of revenue the farmer gets off the acres planted". About 5 years ago the cost of seed was 20% of the revenue on a per acre basis. Even with a 10% price increase, the seed cost as a % of revenue is now down to the 10-11% range.<sup>8</sup>

## Sugar

- The USDA in its January 12th WASDE report raised its forecast of 2022/23 sugar production, slightly lowered imports, and left deliveries unchanged resulting in a jump in the stocks-to-use ratio to 14.9% vs 13.5% forecast in December. The most significant change in the January WASDE report was the US sugar production forecast at 9.25mm short tons, raw value, an increase of 209,000 tons (2.3%) due to increase in cane production in Louisiana coupled with higher actual sugar recovery by beet producers (as measured by the USDA from August through November) resulting in beet sugar up 121,000 tons (2.5%) and cane up 88,000 tons (2.1%). This increase caught some in the industry by surprise following the projected declines in the December report.<sup>9</sup>
- Most of the cane sugar refiners were either sold out or highly sold for the 2022/23 crop as only one cane refiner was offering sugar for spot sale at 0.62 cents/lb. f.o.b. Beet sugar prices for the 2022/23 crop were nominally 0.59 to 0.60 cents/lb. f.o.b. Midwest with some processors offering small amounts, if available. Beet sugar supplies were available mainly from distributors. For the 2023/24 crop year, sales are ongoing with recent offers unchanged at 0.51 cents/lb. f.o.b. Midwest for beet sugar and 0.53 cents/lb. f.o.b. southeast for cane. Most of the 2023/24 sales to date have been for delivery in the October-December quarter of 2023. It was reported that some sellers are being more cautious and not aggressively seeking 2023-24 business at this time.<sup>10</sup>

## Grain and Oilseeds

- The latest USDA Supply and Demand Report decreased domestic stocks of corn and soybeans. The sizable reductions in ending stocks and corresponding price increases should push more acres to be planted to these grains in 2023. The acreage increase may reduce planted acreage for wheat and cotton.<sup>9</sup> South America weather continues to be a key factor in the near-term futures prices. The growing soybean crop in Argentina has suffered from drought. The crop is rated only 4% 'good to excellent' with 56% 'poor to very poor'. The lack of future exports coming from Argentina will contribute to world prices moving higher.<sup>11</sup>
- The Wheat futures have been under pressure as Russian wheat prices are lower on ample stocks, which is keeping a lid on U.S. exports sales and shipments. With adequate supplies and tepid world demand for wheat, it's likely U.S. stocks will grow. However, the market is monitoring the southern U.S. plains which remain dry and could hurt new crop yields during harvest this summer.
- U.S. agricultural exports in fiscal year 2023 are projected to be down.<sup>12</sup> This decrease primarily is driven by reductions in soybeans, cotton, and corn exports. This will be due to the world-wide economic slowdown, increased strength of the dollar and strong grain competition from Brazil. The U.S. will continue to see more domestic soybean processing as soy oil is increasingly used in diesel fuel.

## Dairy

- Milk prices in 2022 were significantly higher than in 2021. Class III (cheese) increased \$4.87/cwt. Class IV (butter) increased \$8.41/cwt. Prices were higher in 2022 as the U.S. emerged from the covid event more quickly than the other major exporting regions, Europe and Oceania. The U.S. exported historical levels of powdered milk products which boosted dairy prices. Exports of nonfat dry milk/skim milk powder were up 10%, dry whey up 17%, butterfat up 43% and cheese up 4%. However, the forecast for 2023 is for lower milk prices. USDA has forecasted the Class III price to be \$2.15/cwt lower than 2022 and Class IV to fall \$4.40/cwt lower than 2022.<sup>13</sup> Milk production should be higher in 2023 as dairy producers respond to higher milk prices by expanding the herd and feeding for more milk per cow. USDA is forecasting increases to both. The possibility of a recession in 2023 provides uncertainty as to the growth in domestic milk and dairy product sales. However, current indicators (lower milk prices and strong world demand) point to a positive 2023 for dairy processors.<sup>14</sup>
- Cheese consumption has been steadily growing for many years. The market continues to expand and shift milk production. A large, new conversion facility opened in Central Texas in December.<sup>15</sup> This new plant has been ramping up and driving milk demand in this region. Furthermore, a large, new plant will open in Dodge City, Kansas in the near future which will further command additional dairy expansion.

## Fresh Produce

- Lettuce and leafy green markets continue to be challenged with a late start to the crop transition in Yuma. California has been dealing with excessive, but much needed rainfall, that has delayed planting in the Salinas Valley. The Salinas Valley accounts for 80% of the nation's vegetables from April to October. Prices remain elevated and stable with weaker demand at the beginning of the year when consumers look for healthy options.<sup>16</sup>
- Fresh produce set new records in dollar sales for 2022 but saw units down 3.6%. December 2022 fresh produce sales reached \$5.5B, surpassing the prior year records by 4.4%. Berries continue to dominate the top ten fresh fruit sellers list. In 2022, fresh fruit added \$2B in additional dollars versus 2021 with fresh vegetables adding \$1.4B in additional dollars.<sup>16</sup>

## Tree Nuts

- Tree nut associations are promoting healthy aspects of their products in response to consumer interest in plant-based and complete proteins. Despite lower prices at the farm-gate, prices at the U.S. retail outlets continue to grow, albeit slower than broader food price inflation, and with the exception of walnuts. See chart below to track growth in organic tree nuts. While volume increases of both organic pistachios and walnuts were significant in 2022, more organic walnuts are sold than any other nut type.

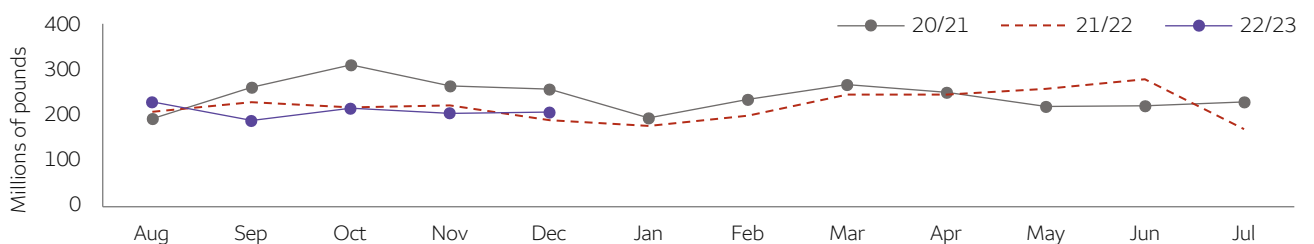
### 2022 tree nuts at U.S. retail

Nut types	Dollarshare	Conventional % YOY		Organic % YOY	
		Volume	Price	Volume	Price
Pistachio	38.5%	0.4	-0.1	8.4	2.2
Almond	29.6%	-11.9	8.7	-9.0	2.5
Pecan	18.6%	-8.5	12.6	0.3	1.9
Walnut	13.1%	-5.5	4.2	6.7	-2.0
Hazelnut/filbert	0.3%	9.4	-4.2	-6.9	6.1

Source: Nielsen IQ

- Shipments will impact price outlook as well. Given 2021's spike in supply chain disruptions, both labor issues and container shortages, we remind the reader to use year-over-year comparisons cautiously. Unfortunately, 2022 and early 2023 are not starting out with enough shipment momentum to expect a quick turnaround in supply and therefore prices.
- For almonds, exports are going in the right direction with December 2022 shipments posting a nearly 24% YOY improvement. Domestic almond shipments were down over 18% in December however, so total shipments are only slightly up over the previous year.

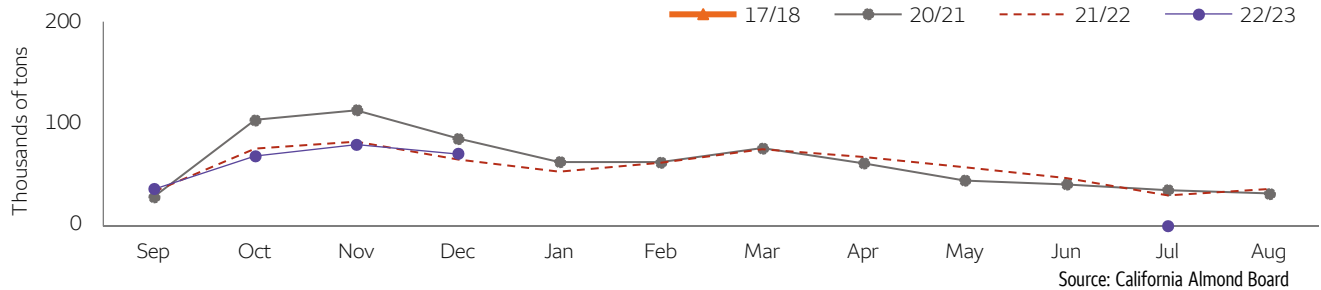
### Total almond shipments



Source: California Almond Board

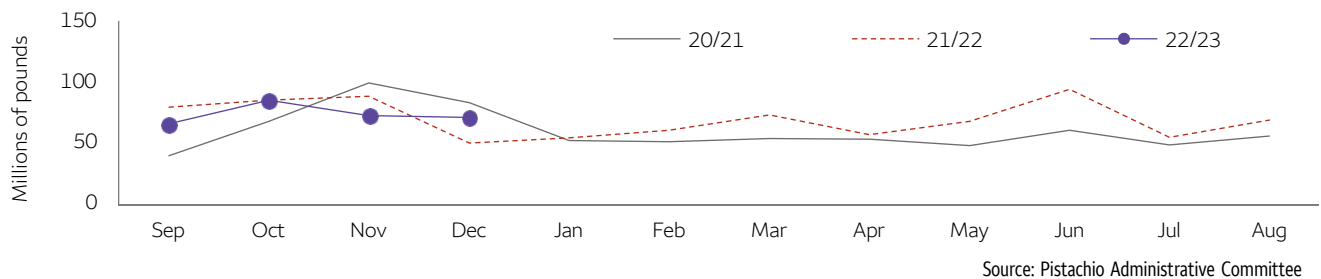
- Total Walnut shipments are up nearly 9% YOY in December, driven by over 21% increase in domestic purchases. December also was the first positive improvement for walnut exports since August. The industry is hoping the 4.4% YOY increase marks a return to stronger export demand.

### Total walnut shipments



- Pistachio shipments are right on track with last year's total volume through December 2022. December's big jump of over 80% YOY in pistachio exports is good news for keeping supply moving for this crop year.

### Total pistachio shipments



- Dormant trees across growing areas are receiving a deep soak from West coast storms which is not only good for replenishing deep moisture but pushing down soil profile salts that can compromise yield potential. Yields will be determined by a bloom impacted by weather, bee-friendly conditions, fungal pressure, and too many variables to make early projections.

## Citrus

- The California fresh market citrus season is well underway with strong supply and favorable pricing. Demand remains strong post-pandemic. Higher costs of water, fuel, and freight do not appear to be affecting citrus sales. Of note, Mandarins are expected to be a much larger crop with harvest running through May. In Comparison, Navel oranges appear to be down 30% this year compared to last year.<sup>17</sup>
- The USDA has forecasted a decline of 18MM boxes in Florida oranges for the 2022/23 crop year. If forecasts hold true, this would be a 56% reduction in final production from last season.<sup>18</sup> It would also be the lowest producing year on record since The Great Depression. Hurricane Ian and Hurricane Nicole are the primary reasons why production has dropped so dramatically.<sup>16</sup>

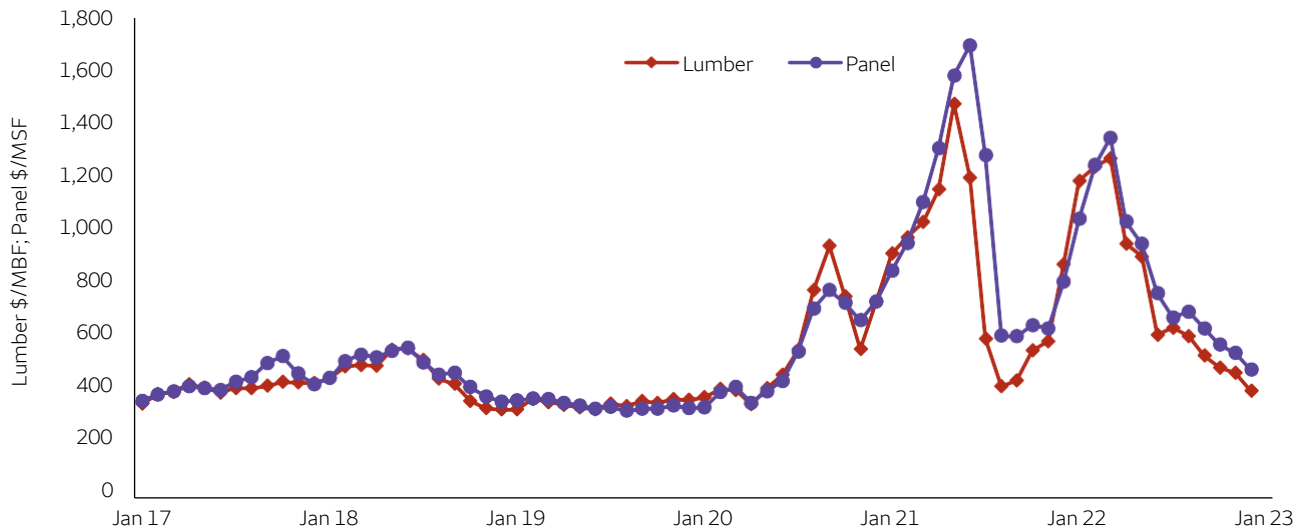
## Forest Products

- Softwood framing lumber prices hit the low point for the year in December 2022.<sup>19</sup> The nominal lumber composite value of \$380/MBF is the lowest week since March 2020 when COVID caused tremendous market uncertainty. Several major lumber producers have announced production curtailments due to "market conditions" in several regions across North America. The market has moved sideways in the past two weeks, and the futures market indicates some price upside potential maybe in 2Q23.



- Structural panel prices also hit the yearly low point in December 2022.<sup>19</sup> The nominal structural panel composite value of \$473/MSF is the lowest week since March 2020. Prices have been comparatively weaker in OSB versus plywood.

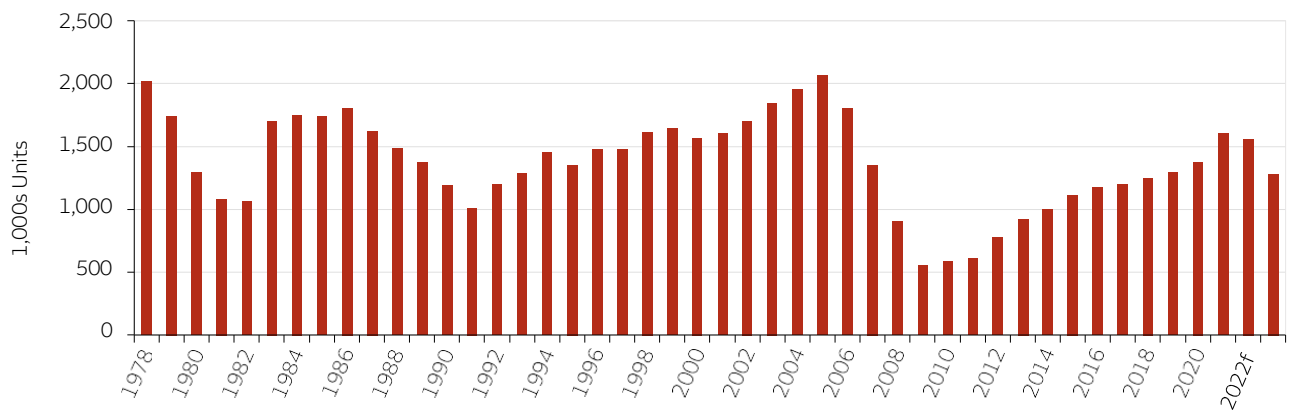
### U.S. Framing Lumber and Structural Panel Composite Prices



Source: Random Lengths, Dec 2022

- The Wells Fargo Economics Group adjusted its US housing starts forecast further downward to 1,280,000 total starts in 2023, which now stands as a 17.9% YOY decline from 2022.<sup>20</sup> Headwinds remain the high cost of housing and high mortgage rates, although 30-year fixed conventional rates have come off about 50 bps since peaking over 7.0% in December.

### U.S. Housing Starts



Source: U.S. Department of Commerce

### Specialty Crops

- Coffee prices closed out 2022 with stability in the \$1.60 per pound price range. This is down from five-year highs at \$2.25 during the pandemic. Global exports in the first few months of the 2022/23 coffee year are up 1.6%.<sup>21</sup>

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