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Allianz Research

Food industry: Gravy for corporates, leftovers for consumers?

Executive summary

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Thanksgiving special: higher turkey prices? Watch out for labor shortages. The consumer price index for poultry increased by +7% y/y in October while producer prices for turkeys decreased by almost -40%. Indeed, US farmers are charging less for turkeys as supply outpaced demand, despite the Thanksgiving spike. A tight labor market in the meatpacking industry explains this paradox.

Overall, agrifood commodity prices will remain higher and more volatile. The last three years have been a bumpy ride for agrifood commodity prices on the back of major disruptions. Though prices of some commodities have started to decline, we expect agrifood commodity prices to remain higher than they were in 2019 because of expensive fertilizers, a weaker dollar and intense financial speculation in the sector. We expect corn prices to stand at USD3.5 per bushel on average in 2024, soybean prices at USD12 per bushel, wheat prices at USD5 per bushel, sugar prices at USD0.25 per pound, cocoa prices at USD4,200 per ton and coffee prices at USD1.4 per pound.

As a result, consumers are actually cutting back on food… With food inflation outpacing headline inflation in both Europe and the US, food sales volumes have been declining. In Italy, volumes were down by close to -4.5% y/y in September 2023, while they decreased by -3% in France, -1.3% in the US and -0.8% in the UK. These declines are also partly because consumers are downtrading, giving up premium brands for cheaper value ones.

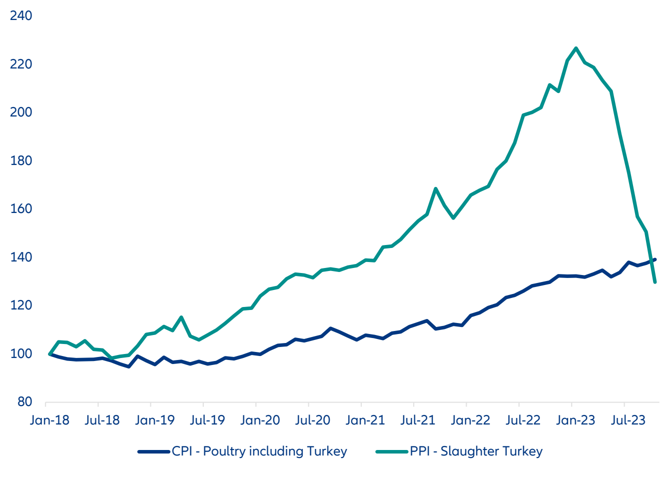
… While the food industry is setting the table for a significant margin recovery in 2024. Food companies in the downstream segment have been able to keep selling prices at current highs even as commodity, energy and transportation costs have declined from 2022 peaks. Operating margins in the sector should hover around 14.7% in 2024 while they were at 11.6% on average in the past twelve months. Among packaged food companies, strong brands in staple food products with high pricing power could even show record operating margins above 17% in 2024 from 14.5% expected for this year. While the sector is resilient risks include the looming debt refinancing wall in 2025 (13% of the sector's total debt outstanding) for zombie companies, and rising insolvencies especially in the downstream segment.

Thanksgiving special: Turkeys need more wingmen

In the US, the farmers' selling price of turkey is falling yet it remains expensive for consumers. Ahead of Thanksgiving, the US has recently observed a notable decrease in the prices charged by farmers for turkeys intended for slaughter. One driver for the declining prices is declining consumer demand: Despite seasonal peaks such as Thanksgiving, consumption rates remain below the supply available, leading to a surplus. This situation exerts downward pressure on prices. However, for consumers, prices continue to rise: The consumer price index for poultry including turkey increased by +7% y/y in October while producer prices for turkeys decreased by almost -40% (Figure 1). Looking at it from a broader perspective, the CPI has increased by +28% since October 2020 while the PPI decreased by -4%.

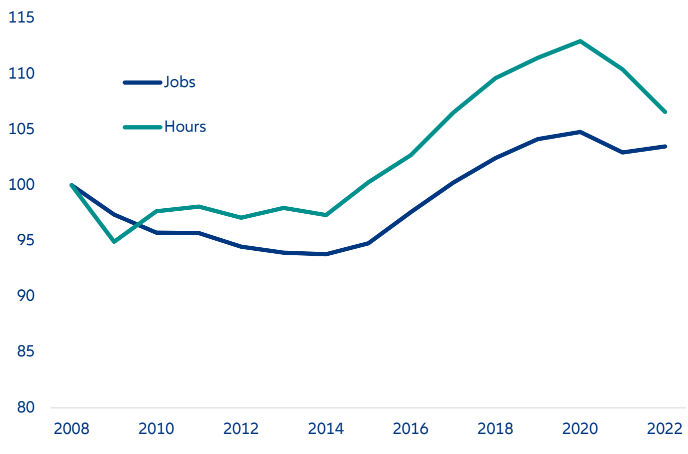
Consumers are paying the price for labor shortages. The different dynamics between selling and retail prices comes down to the labor issues faced by the meatpacking industry in the US as jobs have been stagnating since 2018 and hours have gone down (Figure 2). The sector is currently grappling with significant challenges in job recruitment and retention, given its harsh working conditions. Meatpacking jobs are often physically demanding, involve long hours in cold environments and carry a higher risk of injury compared to many other jobs. Additionally, many meatpacking plants are located in rural areas with limited local labor pools. This coupled with declining interest among younger generations in pursuing careers in meatpacking has intensified recruitment difficulties. Efforts to automate certain processes have been implemented as a solution, but the transition is complex and cannot completely replace the need for skilled labor. Moreover, the technological shift requires huge investments and workers with different skill sets.

Figure 1: US CPI and PPI for turkey (Jan 2018=100)



Sources: Refinitiv, Allianz Research

Figure 2: US animal slaughtering and processing employment indicators (2008=100)



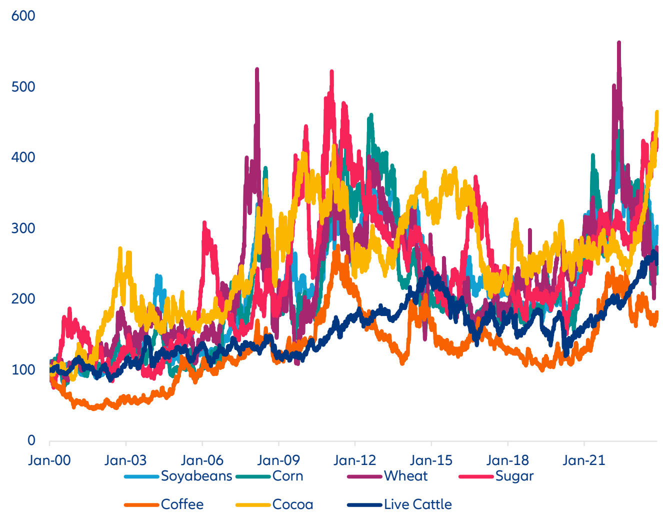
Sources: BLS, Allianz Research

Still pricy commodities and fertilizers

The food sector is seeing a new normal for commodities: pricier than pre-pandemic levels and more volatile. From the pandemic to the onset of war in Ukraine, the agricultural commodity market has been through a bumpy ride over the last three years. However, different commodities followed different prices paths. For instance, prices for cereals such as corn and wheat were highly impacted by the war in Ukraine: Corn prices reached a high close to USD7 per bushel in September 2022 and wheat peaked slightly above USD8 per bushel a month later in October 2022 (though both were still lower than the historical highs of 2012). Composite coffee prices reached an all-time high above USD2 per pound in September 2022, not (directly) because of the war in Ukraine but on the back of poor weather conditions in Brazil, global supply-chain turmoil and rising demand. Meanwhile, sugar, cocoa, rice and cattle prices have reached their peaks in recent months; with the exception of cattle prices, the others are still rising.

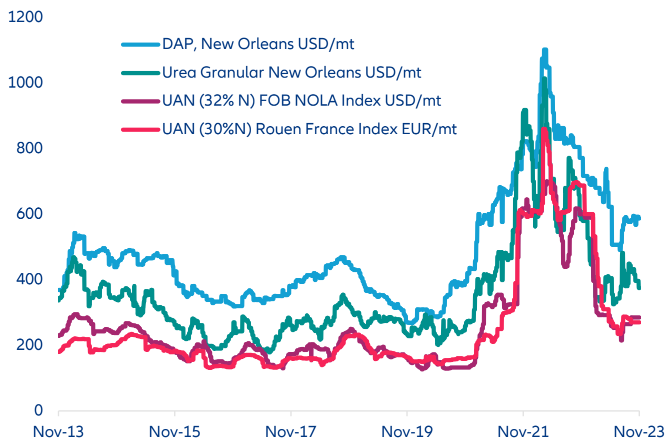
Fertilizers remain expensive amid lingering supply issues. After peaking in early 2022, fertilizer prices have decreased, though they remain high. The easing in prices partly reflects reduced demand as farmers cut back in a context of more expensive and more limited supply in some parts of the world, especially in emerging economies. On the supply side, there have been significant disruptions, especially in Europe. China extended export restrictions on fertilizers until the end of 2022 to maintain domestic availability, leading to a substantial decrease in diammonium phosphate (DAP) and urea ammonium nitrate (UAN) exports. Despite some exceptions, sanctions on Russia and Belarus, which are significant fertilizer suppliers, led to a -50% decrease of potash exports from latter, for example. At one point in late 2022, around 70% of Europe's ammonia production capacity was substantially reduced or shut down. However, with the decline in input costs and the decrease in energy prices, some production facilities might resume operations. Overall, the fertilizer market is going through an easing of prices but lingering supply issues amid an inflationary backdrop mean prices will remain elevated for the next few quarters.

Figure 3: Selected agricultural commodity prices (Jan 2000=100)



Sources: Refinitiv, Allianz Research

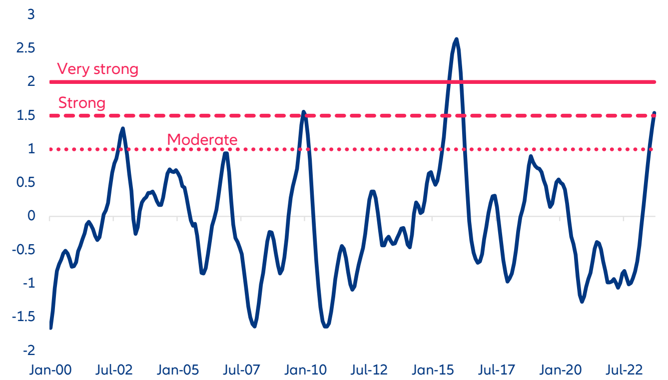
Figure 4: Prices of selected fertilizers



Sources: Refinitiv, Allianz Research

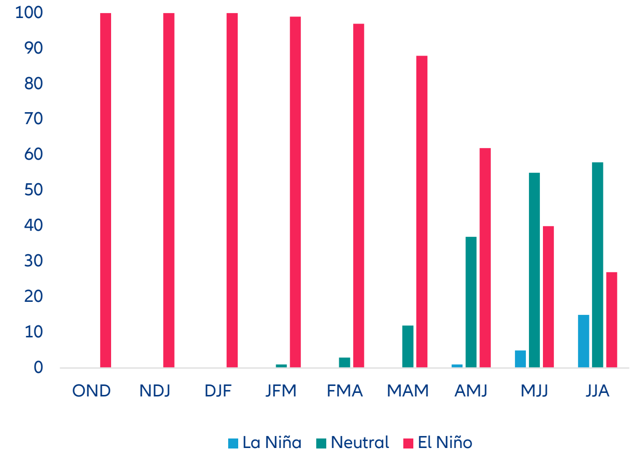
El Niño could push agricultural commodity prices higher again. The El Niño weather phenomenon, which has been quite strong over the recent months (Figure 5), is predicted to continue at least until April 2024 (Figure 6). This could have a significant impact global food prices, affecting both the supply and cost of various staple commodities. El Niño is typically characterized by abnormal rainfall and volatile temperature patterns. This impacts agricultural regions around the world and leads to fluctuations in the production of essential crops. Vegetable-oil production is expected to decline, particularly palm oil in Southeast Asia and soybean oil in the US, leading to potential price increases. Sugar production in major producers such as India and Thailand, is also projected to fall and in West Africa, lower rainfall could reduce cocoa output. However, El Niño's impact is not entirely negative. In Brazil, for instance, increased rainfall could lead to higher harvests of key cereals (i.e. corn and wheat) and soybeans, mitigating grain yield declines in other regions.

Figure 5: Oceanic Niño Index (sea surface temperature anomalies in °C)



Sources: NOAA/CPC, Allianz Research

Figure 6 : Probability of El Niño/La Niña occurrence (% for rolling 3-month periods)

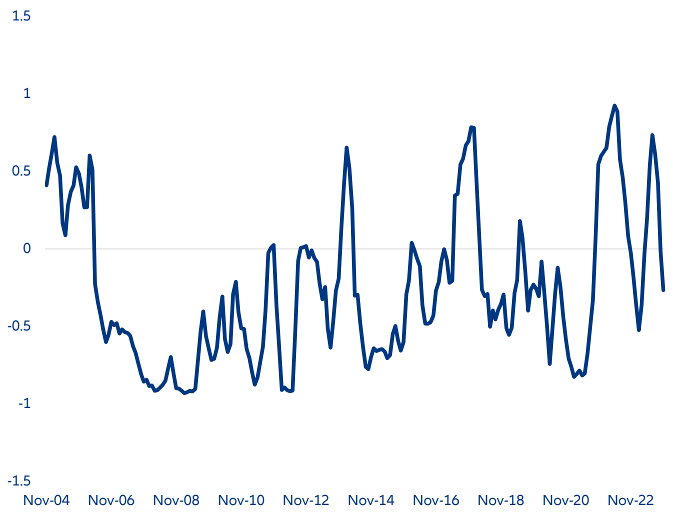


Sources: NOAA/CPC, Allianz Research

Overall, for 2024, we expect agricultural commodity prices to decrease slightly and stabilize at high levels. Corn, soybeans, sugar and coffee in particular should see prices consolidate as production adjusts upward to high prices, and consumer demand remains weak due to the cost-of-living crisis. Brazil is projected to have better crops in 2024, thanks to higher rainfall. Argentina, a major exporter of soy products, is also forecasted to see a recovery in its harvests. However, wheat is expected to face another deficit year and sugar prices are expected dip as output should normalize in Thailand. The coffee market is likely to see a surplus in 2024/25, driven by the recovery of the arabica crop in Brazil and Colombia. However, despite these optimistic forecasts, the agricultural sector continues to face challenges such as high input costs, labor shortages, higher energy prices in Europe and weaker consumer demand. The ongoing war in Ukraine also continues to affect wheat markets and to add to global market uncertainties. The dollar factor also plays an important role. Although the correlation between the dollar and food commodity prices had turned positive in 2022 (Figure 7), it is now negative again (in line with historical dynamics). Since the dollar is expected to weaken in 2024, this means upward pressures for agricultural commodity prices. Overall, we expect corn prices to stand on average at USD3.5 per bushel in 2024, soybean prices at USD12 per bushel, wheat prices at USD5 per bushel, sugar prices at USD0.25 per pound, cocoa prices at USD4,200 per ton and coffee prices at USD1.4 per pound (Figure 8)**.**

Beyond the price risk, expensive food could have severe social consequences, especially in Africa. At the global level, the Famine Early Warning Systems Network, driven by USAID, estimates that some 110mn people will need food assistance through early 2024 due to El Niño's impact on agricultural output and prices. As in 2023, this estimate is higher than the historical average from the recent decade. Africa and Latin America are expected to experience an increase in food assistance needs, especially in countries such as Ethiopia, Nigeria, Sudan, Congo DRC, Guatemala and Venezuela. These countries all rank well below the 100th position in our Social Resilience Index (SRI) , and ongoing pressure on food prices and availability will not ease the situation.

Figure 7: 12-month rolling correlation of SP GSCI Agriculture Commodity Index and Dollar index (DXY)



Sources: Refinitiv, Allianz Research

Figure 8: 2024 average prices forecast for selected commodities

	Last (Nov 15, 2023)	2024
Wheat N°2 (USD/bushel)	5.8	5
Corn N°2 (USD/bushel)	4.4	3.5
Soybeans N°1 (USD/bushe	13.4	12
Sugar (US cent/lb)	25.9	25
ICO Coffee (US cent/lb)	162.2	140
ICCO Cocoa (USD/mt)	4101	4200

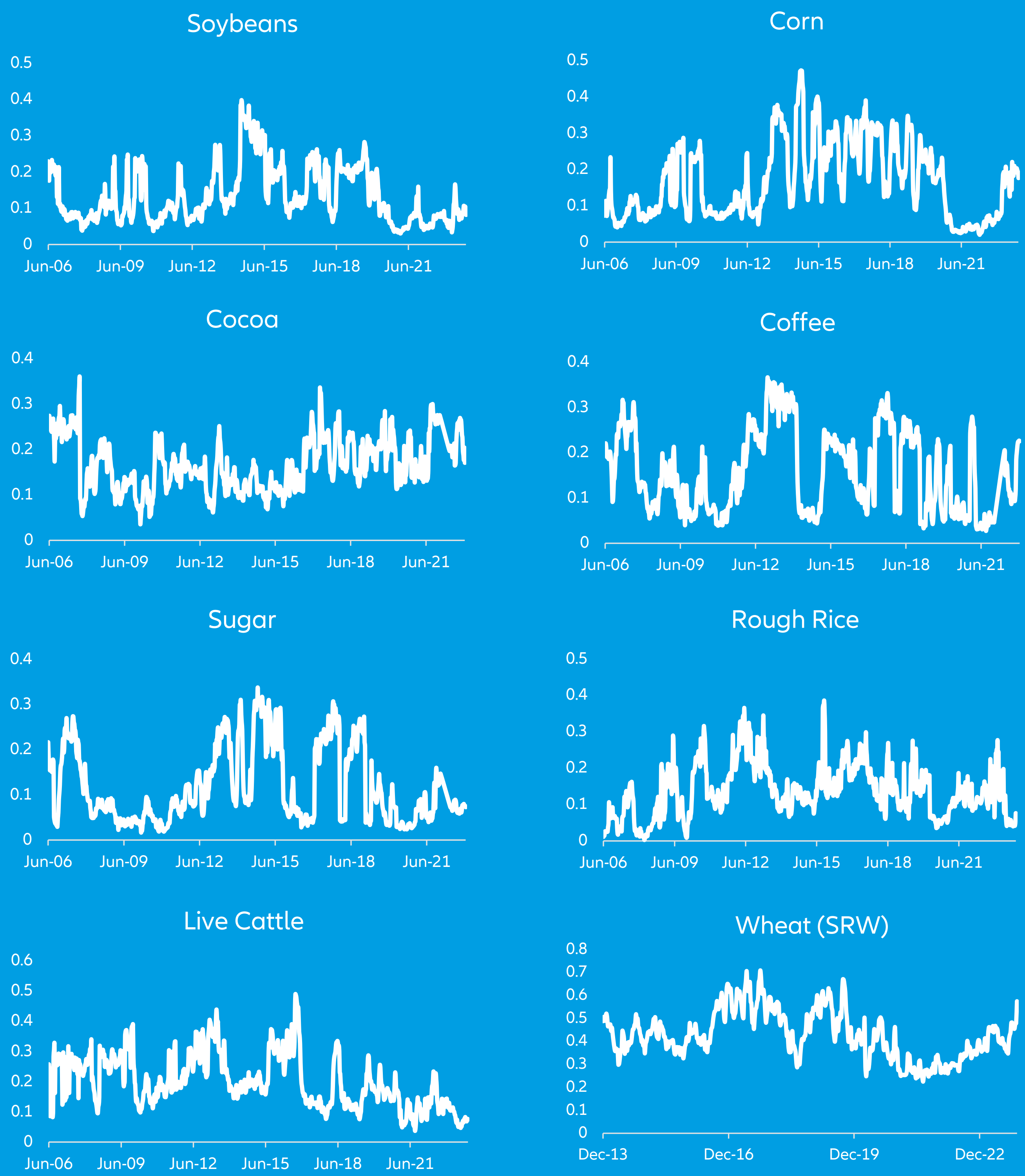
Sources: Refinitiv, Allianz Research

[1] See our report « A bolt from the blue? Amplified social risk ahead »

Corn and wheat are attracting financial speculation

Using data from the Commodity Futures Trading Commission (CFTC), we calculate the Working's Speculative Index, which measures the level of speculative activity by comparing trading positions with purely financial motives against those with "physical" interest in the commodity. We observe that the index for most agricultural commodities is currently lower compared to previous bull market cycles. This suggests a low degree of speculative trading in these markets. However, it is important to note a contrasting trend in certain commodities such as corn, wheat and coffee. For these commodities, the Working's Speculative Index has shown an upward trajectory recently (Figure 9).

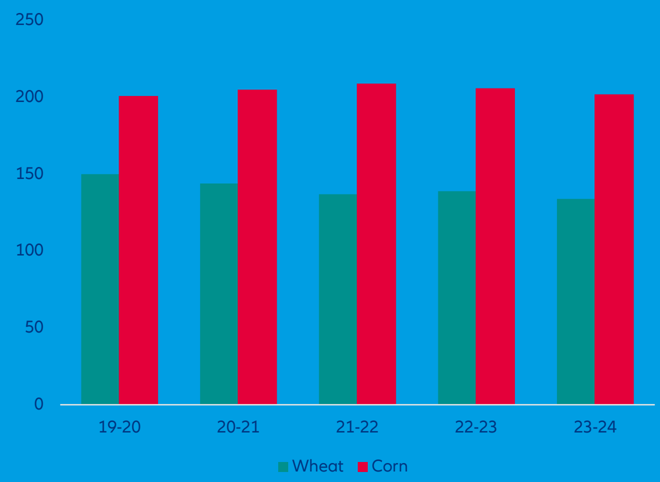
Figure 9 : Speculative index for selected commodities



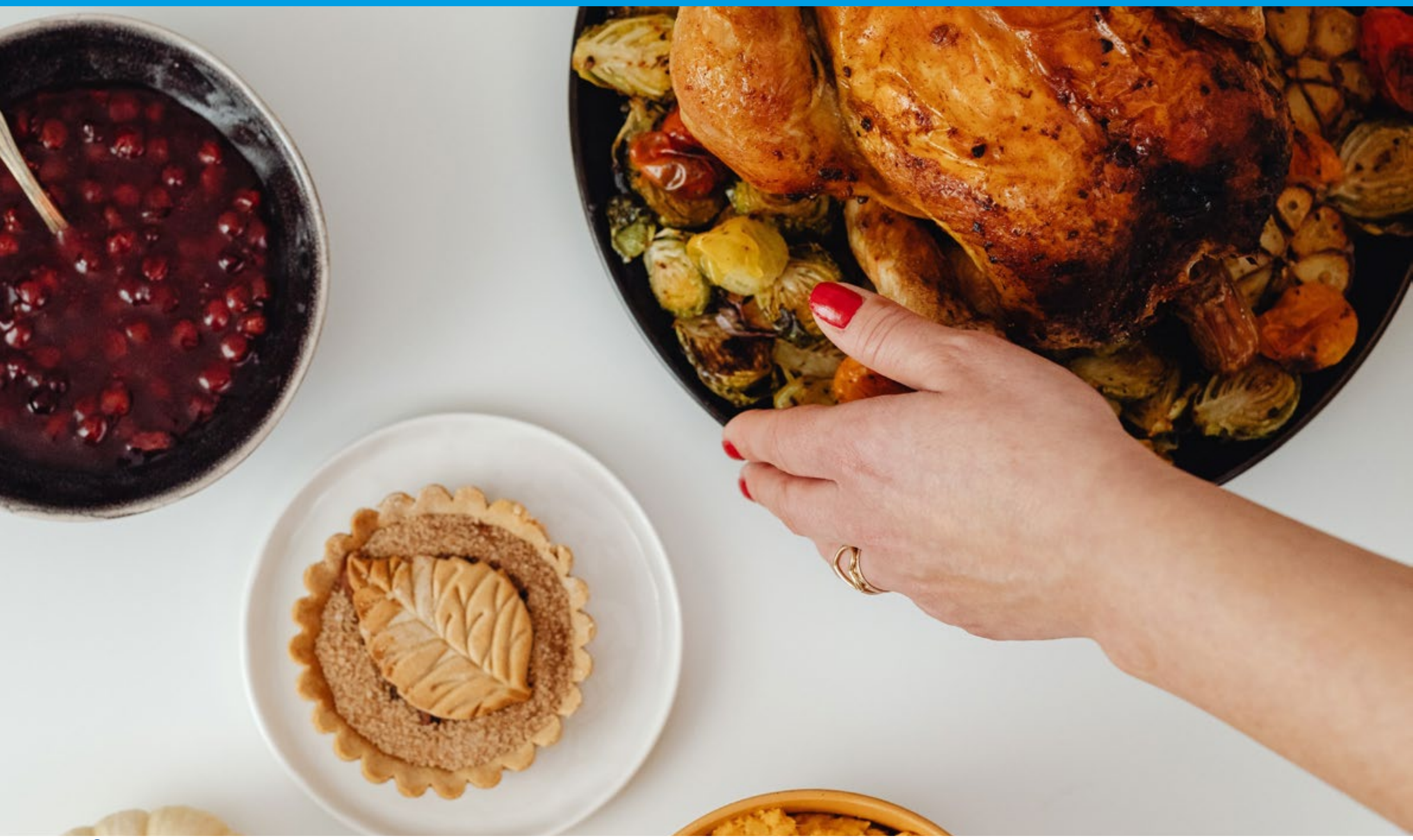
Sources: CFTC, Allianz Research

What about "physical speculation"? We find that China has not been stockpiling agricultural commodities. When commodity prices increase, observers always turn to China to see if the country has bought aggressively to stockpile – i.e. a form of physical speculation. Over the last couple of years, we notice that ending stocks for corn and wheat have been broadly stable (Figure 10). Ending stocks for wheat are expected to increase by a meagre +1.5% in 2022-20023 compared to 2021-2022 while ending stocks for corn are expected to decrease by -1.4% over the same period. Ending stocks for 2023-2024 are projected to decrease by -3.6% for wheat and by -1.9% for corn versus 2022-2023. This tends to indicate that demand from China for stockpiling should not contribute to boosting demand for these key grains.

Figure 10 : Wheat and corn ending stocks for China (mn ton)



Sources: USDA, Allianz Research



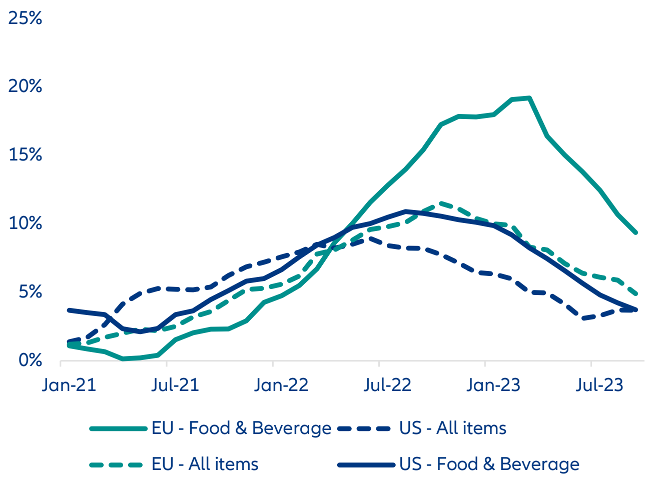
Consumers have begun to cut down on food spending

Food inflation going rogue. In recent months, both the EU and the US have experienced a notable trend of food inflation outpacing headline inflation. This obviously reflects the rise in agricultural commodity prices that we highlighted above, stemming from supply-chain disruptions, the Russia-Ukraine war and rising logistics and fertilizers costs. We notice that the phenomenon is much more pronounced in Europe (Figure 11). Surging energy prices have more severely impacted food-production costs in the region, especially for energy-intensive processes such as refrigeration, processing and the transportation of food products.

In this context, consumers are buying fewer food items and changing brands. In both Europe and the US, we are observing a decline in food sales volumes. In France, volumes were down close to -3% y/y in September 2023 and they have been declining for 12 months in a row now. In Italy, they decreased by -4.5% in September while in Spain volumes have rebounding and in Germany they are now stable. In the US, volumes in groceries have also been diminishing by -1.25% and in the UK they contracted by -0.8%. However, one must keep in mind that volumes are measured as sales deflated and premium brands have been increasing prices more than cheaper labels, thanks to their higher pricing power. Consequently, this fall in sales volumes can be partly attributed to consumers downtrading, i.e. switching from premium brands to cheaper/value labels. In the US, this shift is particularly strong among lower-income groups and those impacted by the elimination of extra Supplemental Nutrition Assistance Program (SNAP) benefits.

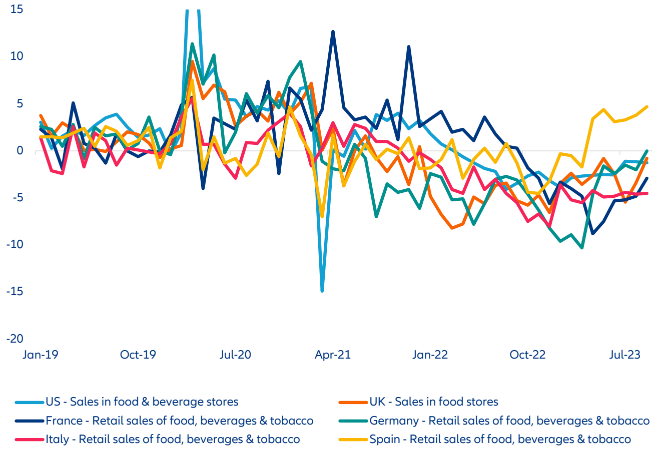
The organic food market is being hit hard in Europe. Over the last decade, the organic food market has experienced robust growth, thanks to changing consumer habits amid increasing awareness of food quality, chemicals, additives and environmental issues. However, the cost-of-living crisis is a major headwind. In 2022, organic food sales in the US continued to grow slightly, breaking the USD60bn mark for the first time. However, in the EU, where food inflation has been more acute, organic food consumption is estimated to have decreased by about -5% in 2022 (Figure 13). The decrease was particularly marked among 'light buyers' of organic products, who are more price-sensitive. Looking ahead, the short-term demand outlook for organic food faces challenges. Although inflation is expected to ease, the relative price of organic food is likely to increase due to higher labor costs as we expect wage growth to remain strong in both regions. Consumer surveys also indicate that while many consumers value sustainability and the quality of organic products, budget constraints and purchasing-power issues remain a priority. These recent developments show that the organic segment cannot defy broader economic trends forever and underlines the need for policies to increase the market share

Figure 11: Food & beverage inflation vs headline inflation (y/y%))



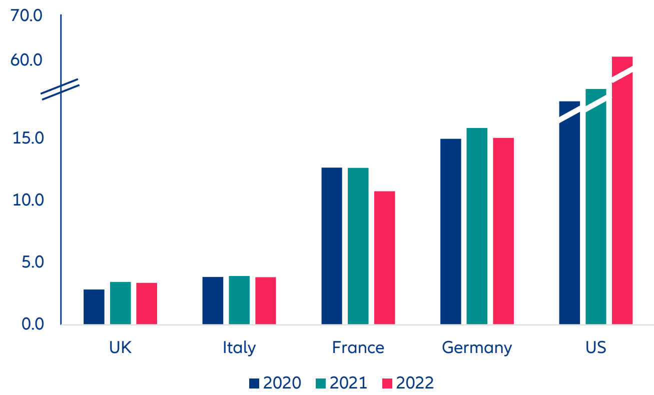
Sources: Refinitiv, Allianz Research

Figure 12 : Food & beverage sales in volume (y/y%)



Sources: Refinitiv, Allianz Research

Figure 13: Organic food retail sales (EUR bn %)



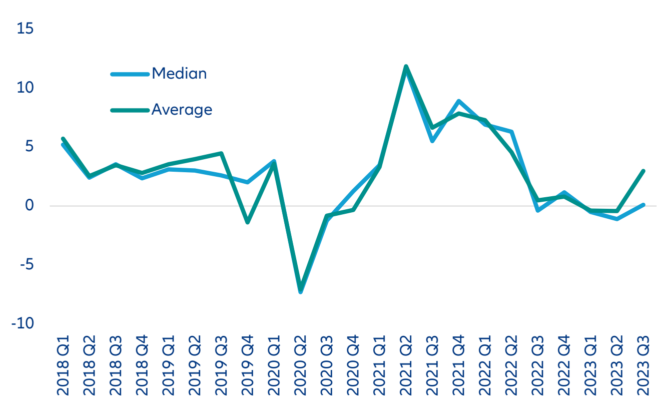
Sources: OTA, AMI, Allianz Research
NB: US is total sales

No volumes? No problem: how price hikes led to a corporate feast

After growing by only around +1% y/y on average between 2015 and 2020, revenues in the food production industry saw a sizable increase[2] of +7% in 2021 and +8% in 2022. In 2021, this jump was driven by higher volumes (partly due to the reopening of restaurants and the return-to-normal for households after Covid-19 lockdowns). In contrast, in 2022, growth was mainly driven by higher prices (due to the increasing prices of fertilizers, pesticides, energy bills and the higher cost of transportation and wages), pushing inflation up both in Europe and the US.

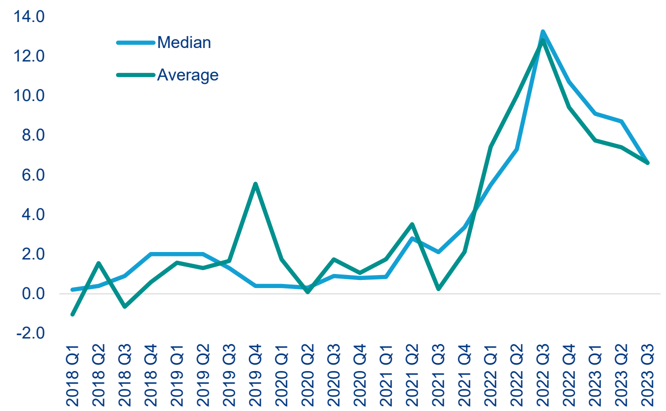
2023 is set to be another strong year for food producers, particularly for packaged food players, with revenues expected to jump by around +7% y/y. Even if prices of some products such as dairy, meat and poultry have moderated from 2022 highs, many packaged products such as beverages, condiments and snacks have remained as expensive as last year, or become even pricier, given their sensitivity to other factors such as packaging and chemical costs (additives, colorants, fragrances etc.). With prices remaining high especially over the first half of 2023, big players in the industry have confirmed or even raised their full-year outlooks for like-for-like sales, even if they have been selling less in volume terms. In Q3 2023, for instance, European packaged food companies increased their prices by +6.6% y/y, versus an average increase of +1.5% between 2020 and 2021, with the peak observed in Q3 2022 (+12.8% y/y).

Figure 14: Sales volume growth (y/y %), 15 largest players in the packaged food segment



Sources: Bloomberg, Allianz Research

Figure 15 Price growth (y/y %), 15 largest players in the packaged food segment



Sources: Bloomberg, Allianz Research

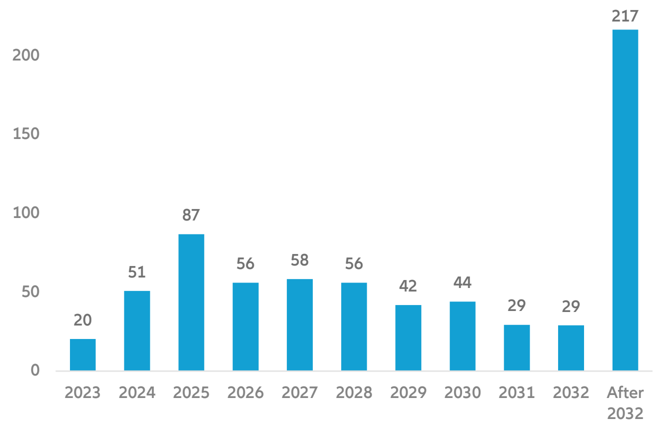
2 Panel: We consider the 100 largest companies (by revenue) in the food industry based in Europe and the U.S.

Food is one of the few sectors with margin improvements on the cards in 2023 and 2024. Out of 20 sectors[3], food and beverages stand 10th in terms of profitability, with an average operating margin of 11.6% in the past twelve months and 12.0% in the past ten years (energy currently holds the top spot with a 12-m trail operating margin of 27.4%, and staples retail is at the end of the list with an operating margin of only 3.3%). Unlike other sectors, we believe the food industry will continue enjoying margin increases in the next twelve months (with operating margins moving to around 14.7% in 2024 on average), considering that the selling prices of most products will remain at 2023 levels, while in parallel the prices of some soft commodities, as well as energy and transportation, will ease from the peaks observed in 2022.

But certain food categories with high prices will start to receive some pushback from consumers. With higher prices largely accepted by customers, processed food companies should have no incentive in the short-term to reduce prices even if production costs continue to decline. However, with the PPI falling faster than the CPI, companies in some regions have been criticized for not adjusting their prices accordingly, especially in the US. Snack food & confectionery in particular is one of the segments where sales could be weaker in 2024 due to its non-essential nature and its limited capacity in the short-term to reduce prices, given that sugar and cocoa remain expensive. However, when we compare it to other segments, snacks has historically been one of the most profitable segments, with an EBITDA margin of 18.3% last year (median value), versus 13.8% for general groceries, 9.7% for meat processing and 8.3% for dairy. This offers a more comfortable cost-buffer capacity.

Overall, most food companies in the downstream segment enjoy good credit ratios and adequate liquidity levels. While it is true that there is a debt wall looming in 2025 (figure 16) that will have to be either repaid or perhaps refinanced at a higher rate, this amount represents only 13% of the sector's total debt outstanding. So the sector does not have any imminent refinancing need. On top of that, its interest-coverage capacity remains robust, thanks to recent earnings improvements: Over the past twelve months, the sector has recorded an EBITDA/interest ratio of 6.3x (above 5.3x for the full corporate universe).

Figure 16 : Corporate debt[4] maturity profile (food processors and beverage companies), amount outstanding (USD bn)

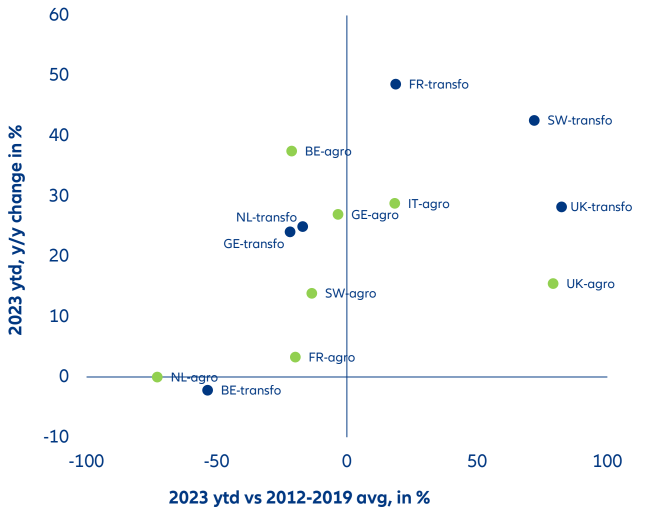


Sources:Refinitiv, Allianz Research

[3] CIGS sector classification (only non-financial corporates), using average figures for listed companies in the US and Western Europe
[4] Corporate debt includes bonds, certificate of deposits and commercial papers

Business insolvencies are low but picking up. The agrifood sector accounts for a small share in domestic business insolvencies, mostly representing less than 2% of the total historically, with the notable exception of France (5% over 2012-2019 average). When comparing their relative respective contribution to national insolvencies, upstream sectors (farming to fishing/aquaculture) so far looked more fragile in France, the UK and the Netherlands, while downstream sectors (food and beverage manufacturing) seemed more fragile in Germany, Sweden and Belgium. However, most upstream and downstream sectors already experienced an increase in insolvencies in 2022, in particular in the UK, the Netherlands and Sweden, ahead of France. The upside trend has been gaining traction in 2023, with downstream sectors leading the way, in particular in France and Sweden (+49% y/y and +43% y/y, respectively for the year-to-date outcome). Insolvencies have risen above the historical level in France, the UK and Sweden. Yet, Italy and UK stand out with an already high number of insolvencies in the upstream sectors from a historic perspective.

Figure 17: Insolvencies



Sources: DeStatis, Istat, ONS, Statbel, SCB, Allianz Research
(*) Italy: the number of insolvencies is not available for the transformation sub sector.

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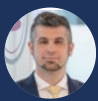

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About Allianz Research
Allianz Research encompasses Allianz Group Economic Research and the Economic Research department of Allianz Trade.