Report: Drought, Livestock Disease Likely to Increase US Food Prices

Euler Hermes

The United States is one of the largest food producers in the world. With total agri-food exports exceeding $144 billion in 2013, the U.S. has become a major supplier to many countries, including Hong Kong, China and Philippines, among others. In the short run, although at a slower pace, economic growth, dietary changes and urbanization in emergingcountries are expected to drive demand while demographics (population and a risingmiddle class) will continue to play a crucial role in long-run growth.

With a growing dependence on U.S. production, the impact of any supply disruption is far-reaching. The current drought in California and disease in livestock have contributed to higher prices for consumers domestically, as well as some consumers abroad. Going forward, the industry’s ability to manage such disruptions will determine the impact on industry margins and consumers’ wallets.

Outlook

Several factors are impacting food prices. In the near term, the impact of the California drought is expected to become more severe as the year goes on, as several products such as lettuce, tomatoes, avocados, tree nuts, and grapes are expected to have lower yields than in years past due to the water shortage. Pork prices are also expected to remain high for the foreseeable future due to an outbreak of Porcine Epidemic Diarrhea virus, known as PEDv, which only infects pigs. The virus has been detected in over 4,700 farms and 27 states. In the long term, no relief is in sight for beef prices as cattle inventories have reached lows not seen since the 1950s, when the U.S. population was roughly half of what it is today. Cattle ranchers slaughtered their livestock at higher rates over the past two years as feed prices skyrocketed due to the mid-west drought. Several years will be required to replenish herds. These factors are expected to result in lower volumes at higher prices for growers and ranchers. Despite an improving U.S. economic environment, retailers will only be able to pass on a portion of these higher prices, which could squeeze operating margins.

Challenges

The rising prices pose challenges for food manufacturers, distributors, retailers, and eating establishments. While consumers will absorb some increase in prices, these businesses will find it difficult to fully pass on the higher input costs. This challenge can already be seen as producer prices for several commodities have increased faster than consumer prices during the first quarter of 2014. At the manufacturing, distribution and retail levels, this may result in lower margins. During the last spike in agricultural commodity prices in 2009 –2011, the food and beverage industry was only able to raise prices by 21%, whereas commodity prices rose 35%. While the economy is in better standing this time around, the ability to fully pass on higher commodity prices will continue to prove difficult for the industry.

Opportunities

International demand for U.S. agricultural commodities remains strong, particularly in Asian countries where the middle class continues to grow. Exports of almonds, beef, pork, poultry, wine, and dairy products have all increased steadily over the past several years and the trend is expected to continue in 2014. While growing exports will have an impact on prices for consumers locally, the developing international market presents a growth opportunity for U.S. growers in 2014 and beyond. Export destinations for U.S. agricultural products that have seen the most growth include Hong Kong, China, the Philippines, Canada, Indonesia, and Turkey; all of which have seen exports increase more than 25% over the past 5 years, and over 100% in the cases of Hong Kong and China. Other major trade partners include South Korea, Japan, Mexico, and the European Union.

What this means for your business

As international demand for U.S. agri-food increases, growers and producers will need to find a secure method of conducting business across borders. For food suppliers that prefer to continue to do business only in the U.S., the short- to medium-term margin compression could result in a riskier customer base. Obtaining a trade credit insurance policy from Euler Hermes would help mitigate the risks of slow pay and bankruptcies domestically, while also providing a secure means to expanding sales globally.