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Dear Client: Washington, Sept. 10, 2021

New view boosts U.S. ag trade outlook...
USDA adopted World Trade Organization's definition of ag products, which adds ethanol and other products to the total... see box at right. Result is higher projected levels for both ag exports and imports and trade deficits for fiscal years (FY) 2019 and 2020.

AG TRADE

U.S. ag exports & imports will set new records in both FY 2021 and 2022, with USDA adoption of the WTO definition of agricultural products. The new definition was not part of USDA's May outlook.

USDA expects record FY 2021 U.S. ag exports of $173.5 bil. against imports at a record $157.5 bil. for a $16.0 bil. surplus. In May, using the old definition of agricultural products, the forecast was for exports of $164 bil. against imports of $141.8 bil. for a surplus of $22.2 billion. USDA noted the higher forecast is in part due to the updated definition "which adds ethanol, distilled spirits, manufactured tobacco, and others to the agricultural total."
FY 2022 exports are forecast at a new record of $177.5 bil. vs. imports at a record $157.5 bil. for an $18 bil. surplus, according to USDA.

Economy, new definition drive imports higher...
Forecast includes a big boost in FY 2021 imports to $157.5 bil., up $15.7 bil. from the previous forecast... primarily due to the inclusion of distilled spirits and other products being added to the mix of agricultural imports. "Record-level import values in the third quarter of FY 2021, largely due to pent-up demand from the pandemic shutdowns of entertainment and service industries, which was released, driving up purchases and prices of wine, beer, fruits and vegetables, and other horticultural products, at least in the short term," USDA said.

U.S. Ag Trade

More records are forecast based on USDA's adoption of the WTO's agricultural products definition. The following takeaways are of particular note.

- FY 2021 and FY 2022 agricultural exports and imports are expected to set records.
- U.S. is forecast to return to trade surplus after two deficit years.
- U.S. ag exports to China expected to hit $37 bil. in FY 2021, and $49 bil. for FY 2022.

The WTO's definition of "agricultural products" adds ethanol, distilled spirits and manufactured tobacco products, among others, while removing rubber and allied products from the previous USDA definition. The WTO's definition of agricultural trade now embedded in forecasts.

Source: USDA, Foreign Ag Service

Net effect of the new definition on historical trade values: U.S. ag exports averaged $4.7 bil. higher per year during FY 2018–2020 from the previous definition, and U.S. ag imports averaged $9.9 bil. higher annually during the same period.
Other impact of the new definition: U.S. ag registered trade deficits of $1.3 bil. for FY 2019 and $3.7 bil. for FY 2020.

FY 2021 U.S. ethanol exports are forecast at $2.2 bil., down by $60 mil. from the prior year, with "higher export unit values only partially offsetting lower export volume," USDA said. Reason: Exports to Brazil "have fallen to levels not seen in a decade." Also, Colombia's lower blend mandate has cut U.S. exports to that destination. Lower sales of ethanol to Mexico and Nigeria also came into play.

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Subscription inquiries: 888-752-2047 or AgricultureLetter@farmjournal.com
Editorial information: Tel., 800-772-0023; Fax, 319-277-7982;
E-mail: agletteditors@farmjournal.com; or website, AgricultureLetter.com

U.S./CHINA AG TRADE

China top customer for FY 2021, 2022. FY 2022 ag exports to China are forecast at $39.0 bil., up $20 bil. from FY 2021 forecast of $37 billion. In FY 2020, USDA pegged those shipments at $16.97 billion. So far in FY 2021 (October-June), U.S. ag exports are at $28.28 bil., up from just $11.07 bil. in the same period in FY 2020. The rise in FY 2022 forecast U.S. ag exports to China is driven by "higher expected soybean prices and strong cotton and sorghum demand."

For FY 2021, USDA increased its forecast by $2 bil. vs. May "mainly due to a quickening pace of corn shipments in recent months, strong sales of beef, and the addition of ethanol." And ethanol was a key add… FY 2021 U.S. fuel ethanol exports to China "reached their second-highest level on record due to low, early-year U.S. prices," USDA says.

China returning as our top customer is not surprising given the Phase 1 agreement. But remember that the forecasts outlined by USDA are for the October through September fiscal year, not the calendar year that the Phase 1 agreement is based on. So… the figures are not quite an "apples-to-apples" comparison. But they do underscore the impact of the agreement on U.S. ag exports.

FOOD SUPPLY

Labor shortages are slowing the supply chain, and distributors are struggling to get food to stores on time. Some of the largest U.S. food distributors are reporting difficulties in fulfilling orders as a lack of workers weighs on the supply chain, *Bloomberg News* reported. Sysco Corp., North America's largest wholesale food distributor, is turning away customers in some areas where demand is exceeding capacity. The Houston company also said prices for key goods such as chicken, pork and paper products for takeout packaging are climbing amid tight supplies. In particular, production has slowed for high-demand, labor-intensive cuts such as bacon, ribs, wings and tenders, Sysco said.

Another major distributor, United Natural Foods Inc., is having trouble getting food to stores on time. The company said the labor shortages, as well as delays for some imported goods — including cheese, coconut water and spices — are causing the problems. "We anticipate additional supplier challenges in the short term with gradual improvement through the fall and winter," a United Natural Foods representative said.

Sysco is aggressively hiring warehouse workers and truck drivers and offering referral and sign-on bonuses along with retention money for current staff. The entire food sector is seeing "massive labor shortages," said Benjamin Walker, senior vice president of sales, marketing and merchandising at Baldor Specialty Foods, a New York distributor. "Service levels are the lowest I've seen in my 16-year career, and it doesn't seem like it's going away anytime soon." Finding truck drivers is "next to impossible," he said, and freight costs are rising daily. The company's orders are arriving late and consequently facing delays in being sent to customers.

On the outbound side, on-time deliveries are still above 50% but have fallen from the usual rate of more than 90%.

Meanwhile, McDonald's dropped milkshakes from its menus in the U.K. because of what it called "supply chain issues."

RAILROAD

K.C. Southern is taking a new look at a $27 bil. offer from Canadian Pacific. A larger deal with Canadian National was thrown into doubt after the Surface Transportation Board ruled that a "voting trust" proposed by Canadian National in its bid could not be used.

Higher offer ahead? The board of the railroad, which is headquartered in Kansas City, Mo. and runs between that city and Mexico, said Canadian Pacific's offer "could reasonably be expected to lead to a "superior" offer than the one Canadian National made in May to buy the railroad for $30 billion.

Kansas City Southern said it would open its books to Canadian Pacific, but that the move would not necessarily lead to a deal.

If Canadian National acquires Kansas City Southern, the railroad would be the third largest on the continent. A tie-up with Canadian Pacific would result in a railroad that's still the smallest of the six remaining big rail operators.

CONGRESS

Lawmakers are facing several key deadlines this month.

Before October, the House wants to pass two major pieces of legislation: a $1-tril. bipartisan physical infrastructure bill and a $3.5-tril. spending package backed by Democrats that would advance key parts of President Joe Biden's economic agenda. They'll also need to pass gov't funding legislation to avoid a shutdown on Oct. 1.

There's a Sept. 27 deadline to vote on the bipartisan infrastructure bill, as committee chairs work to finish drafting their portions of the larger spending package by Sept. 15 to hold a floor vote shortly after. Several centrist Democratic senators insist the $3.5-tril. price tag must be lowered to get their votes.

There is also the Sept. 30 deadline to avoid a gov't shutdown as Congress must fund the gov't for the fiscal year starting Oct. 1. A short-term continuing resolution is likely into December, allowing the gov't to keep funds flowing at current spending levels as lawmakers carry on with negotiations over a longer-term spending bill.

MARKETS

Corn: USDA is expected to boost corn production in its September update so traders are now wondering how low corn futures could go. Some note recent corn price action opens downside risk to $4. But most analysts think $4 is way too low for what will pan out. One analyst says prices are unlikely to drop "much below $5 unless ending stocks push above 1.5 bil. bushels. China and others will buy; Brazil doesn't have enough corn to actively export."

Soybeans: China continues to buy U.S. soybeans, and its appetite appears robust. Meanwhile, the *Economist* reports Russia's gov't has started leasing land in the country's far east to Chinese, South Korean and Japanese investors. Much of the land, which was once unproductive, is now used to grow soybeans. Most are imported by China, helping the country reduce its reliance on imports from America. Russia's deputy minister of ag has predicted that soybean exports from its far-eastern farmlands may reach $600 mil. by 2024, nearly five times what they were in 2017.

Wheat: Russian wheat crop estimates continue to slide. Russia-based ag research firm SovEcon recently dropped its production forecast from 76.2 MMT to 75.4 MMT, citing low spring wheat yields. Crops in the Urals and Volga Valley were hurt by hot, dry summer weather and those crop losses were only partially offset by higher production in other areas. Rising domestic prices and export tariffs have shipments lagging year-ago.

Cotton: Recent U.S. export sales and shipments suggest cotton prices over 90¢ per pound were curbing demand. But subsequent futures strength implied mills may be short bought on needs.

Hogs/pork: The CME lean hog index has been falling seasonally, dropping nearly 20% from a seven-year high registered in June. At that rate, some argue that October futures trading around $90 are overvalued. But such an argument ignores the hog and pork complex's tendency to rise during September and early October. On average, the index has bottomed in the second week of the month, then rallied over $4.00 into mid-October during the past 10 years. Given soaring meat demand, tight stocks, and the forecast 3% annual drop in hog supplies, the "normal" rally seems likely again this year.

Cattle/beef: October live cattle's dive after topping the pivotal $130.00 level on Aug. 23 implies renewed pessimism about the fall price outlook. Traders apparently expect a wholesale market breakdown in the wake of the midsummer surge to a fresh 2021 high, thinking the Delta variant of Covid-19 will curtail consumer buying. *Pro Farmer* analysts think fears are exaggerated and expect cash prices to rally in the months ahead.

Transportation: Shortages of truck drivers and warehouse workers are making shipping delays worse as the need to replenish inventories is at an all-time high. Industry analysts don't see that changing until well into 2022. The congestion has contributed to a worldwide shortage of shipping containers and to spiraling costs for ocean freight.

FOOD PRICES

USDA raises food price inflation forecasts for 2021.

U.S. food price inflation of 3.0% to 4.0% is likely in 2021, forecasts USDA's Economic Research Service (ERS)… up from its prior forecast for food price inflation of 2.5% to 3.5% in 2021.

Overall food prices increased 3.4% in 2020. The midpoint of the updated forecast… 3.5%… would come in just above last year's increase.

Food away from home (restaurant) prices, are likely to rise 3.5% to 4.5% in 2021 compared with 2020, when they rose 3.4%, forecasts ERS.

Food at home (grocery) prices are now forecast to increase 2.5% to 3.5% in 2021, up from ERS's prior outlook for an increase of 2.0% to 3.0%. But that would fall short of the 3.5% rise registered in 2020.

Forecasts for 2021 have all increased since USDA's initial outlook issued in June 2020. At that point, ERS expected overall food prices to increase 2.0% to 3.0% in 2021, with grocery store prices expected to climb 1.0% to 2.0% and restaurant prices to increase 1.5% to 2.5%.

No change to USDA's 2022 outlooks on food prices. ERS left its 2022 food price inflation outlooks steady with previous forecasts, with all food prices expected to rise 2.0% to 3.0%. ERS expects grocery store prices to move up 1.5% to 2.5% and restaurant prices to increase 3.0% to 4.0%.

Several shifts in specific commodities…

Forecast ranges for 12 of 22 food categories were revised upward for 2021, including those for beef and veal, pork, poultry, fish and seafood, dairy products, fats and oils, and sugar and sweets.

Meat prices are now forecast to rise 3.5% to 4.5% in 2021, with beef prices seen increasing 4.0% to 5.0%. But that forecast increase in beef prices would still be well under the 9.6% rise registered in 2020. USDA noted beef, pork and poultry prices have seen five straight months of increasing prices, saying: "prices have been driven up by strong domestic and international demand, high feed costs, and supply chain disruptions. Winter storms and drought impacted meat prices this spring, and processing facility closures due to cybersecurity attacks impacted beef and other meat production in May."

Fish and seafood prices are also slated to rise 3.0% to 4.0% in 2021, an increase from ERS's prior outlook. ERS chalks the increased outlook up to "low imports, labor shortages and strong domestic demand, particularly in the foodservice sector."

The pandemic has caused several impacts across the U.S. food supply chain, including much higher prices for some foods in 2020, as interruptions hit the system. But the reopening of economic activity and removal of restrictions in states and cities has seen restaurants reopen for in-person dining and higher food and labor costs are clearly contributing to higher restaurant prices. That reflects the overall higher inflation situation across the U.S. economy, which feeds back into restaurant prices, in particular, as they include factors outside of those at grocery stores.

As for the outlook for 2022, history shows USDA's forecasts will evolve. But even though ERS made no change to its forecast inflation levels for 2022, the expected increases are still coming from a higher starting point of 2021 prices. Bottom line: Consumers will still feel the pinch of higher food prices.

Best regards,

The Ag Letter Editors

THE AGRICULTURE LETTER EDITORS

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