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US Potato Outlook 2023/24

After a Record-breaking Year, What Is in Store for US Potatoes?

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Summary

US potato production declined for the fourth consecutive year and this season’s crop is the smallest since 2010. Potato prices surged to their highest levels, accordingly. Strong demand for frozen potatoes also contributed to the high price environment.

Strong open market prices and strong demand for frozen potatoes are typically sufficient reasons to raise contract prices, particularly since heightened demand for processing potatoes has gone unmet for two years running and fryers were able to pass on costs to consumers without a loss in sales.

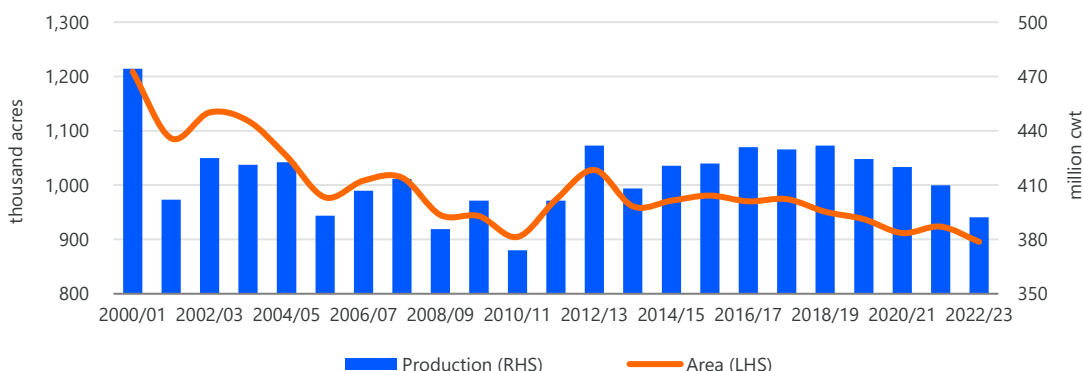
Competitive open market and higher contract potato prices, an improved water outlook, and crop rotation pressures are expected to increase potato planted area by 2% YOY and lead to a 7% drop in price in the 2023/24 marketing year.

Growers, through their cooperatives and associations, are in a good position this year to negotiate better contract prices with processors. **Fryers**, who had to rely on imports and sourcing raw inventories from other regions with better supply situations, have strong economic incentives to increase contract prices and improve contract terms, given strong demand for finished products. Although **consumers** will pay higher prices for fresh potatoes, french fries, and other frozen potato products, they are not expected to reduce their potato consumption. The potato is extra precious during a period of inflation, when consumer purchasing power is eroded.

A Record-breaking Year

For the first time, US potato production declined for four consecutive years, reaching its lowest level since 2010 at about 390m cwt (see Figure 1). Also, at 893,000 acres, harvested area was the smallest on record. A rare confluence of factors and sequence of events, explained at length in Rabobank’s report *US Potatoes in the Spudlight*, led to declining production in the past three marketing years.

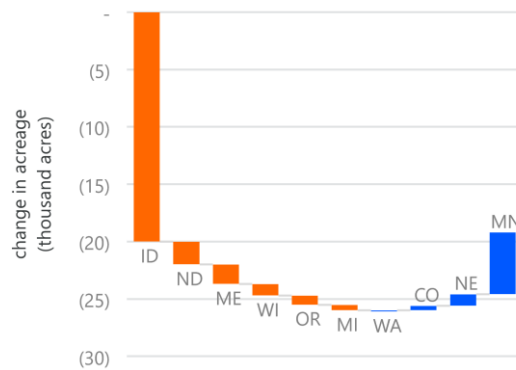
Figure 1: US Potato production and area break record lows, 2000/01-2022/23



Source: USDA NASS, Rabobank 2023

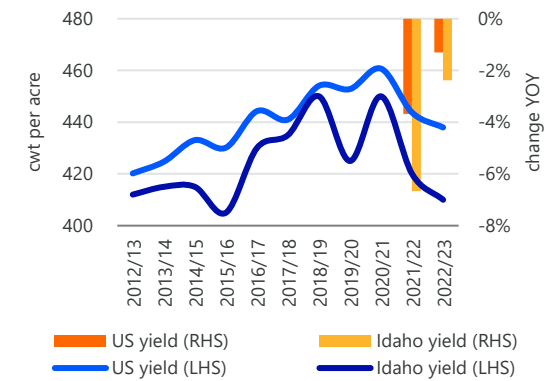
In the current marketing year, production declined primarily as a result of a sizable drop in Idaho's area coupled with below-average yield (see Figures 2 and 3). Widespread water shortage played a big role in reducing planted acreage and yield. In addition, continued competition over acreage from other crops, such as spring wheat and barley, and delayed planting due to cold spring weather contributed to the drop in area and weakened yield, respectively.

Figure 2: Water shortage and crop competition caused a sizable drop in Idaho's potato area in 2022 vs. 2021



Source: USDA NASS, Rabobank 2023

Figure 3: Delayed planting negatively impacted yield, particularly in Idaho, in 2022/23

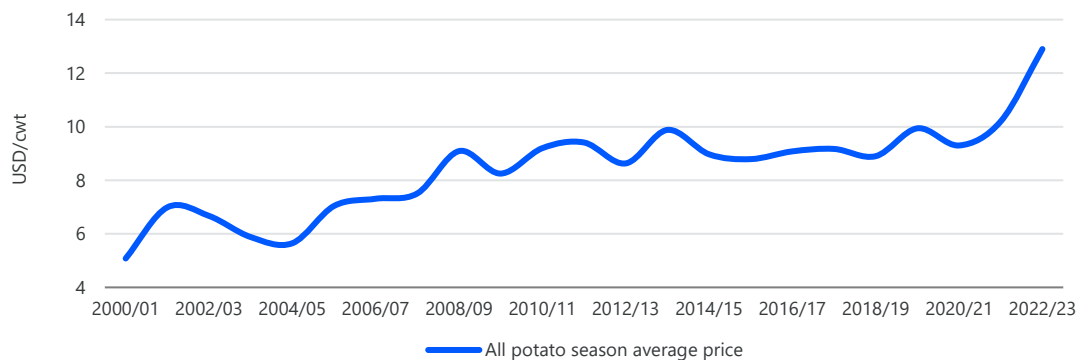


Source: USDA NASS, Rabobank 2023

While we expected potato planted area to decline, the magnitude of the drop surprised everyone. In retrospect, heightened uncertainty among growers about water outlook and allocation based on senior and junior water rights increased both production and contract risk. Indeed, risk-averse growers with junior water rights likely chose to plant crops that require less irrigation, such as feed grains and legumes, and opted out of contract production to avoid any risk of not meeting negotiated volumes, quality, or delivery terms.

In response to the small crop, potato prices surged to their highest level on record. Growers' season-average price for all potato types was a few cents shy of USD 13/cwt, up about 26% YOY and 36% higher than the five-year average (see Figure 4).

Figure 4: Growers' season-average price for all potato types reaches a record high, 2000/01-2022/23

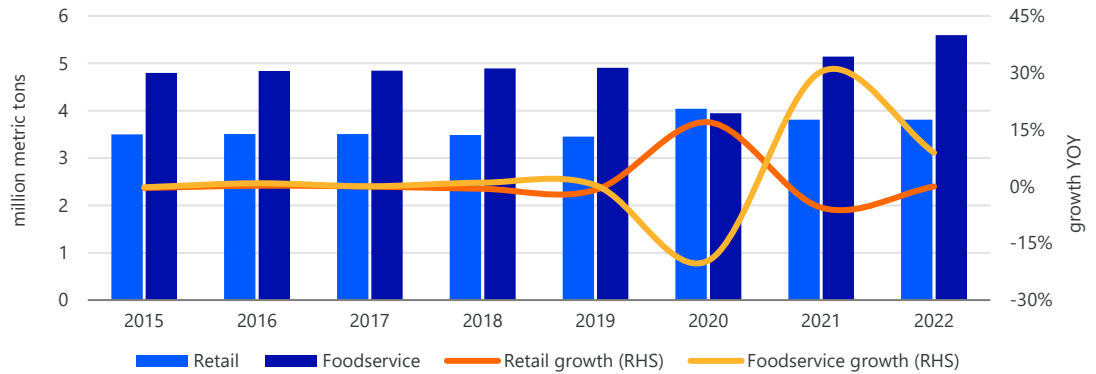


Source: USDA NASS, Rabobank 2023

Strong Demand for Frozen Potatoes

Over the last two years, demand for frozen potatoes has been on a path to recovery. In 2021 and 2022, foodservice sales of frozen products grew at an impressive rate of 30% and 10% YOY, respectively, pushing total sale volume to above pre-Covid levels (see Figure 5).

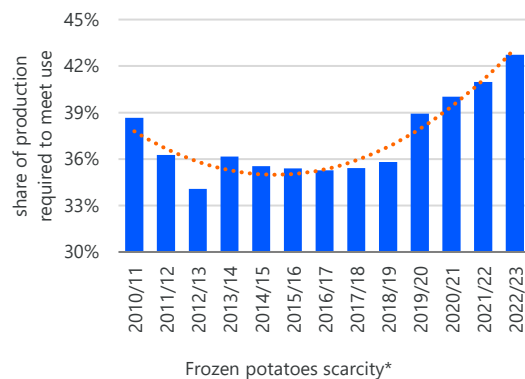
Figure 5: Frozen potato sales growth rate in positive territory thanks to foodservice demand, 2015-2022



Source: Euromonitor, Rabobank 2023

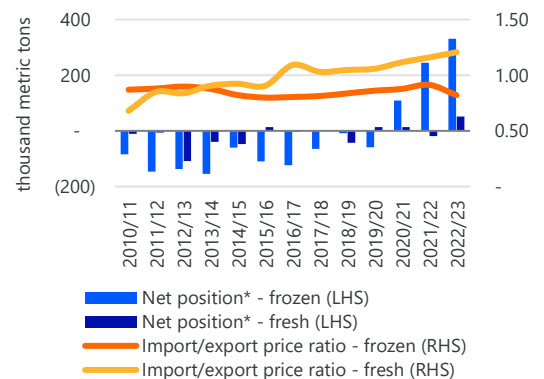
However, with declining production, frozen potatoes have become scarcer. In recent years, it has taken a higher percentage of production to satisfy average use of frozen potatoes (see Figure 6). Dwindling frozen potato inventories led to unprecedented growth in imports. In the current marketing year, the US has reached its highest net import position in frozen and fresh potatoes on record (see Figure 7). Tight domestic frozen potato inventories led importers to seek cheaper frozen potatoes in the global markets to satisfy strong domestic demand. Imports of fresh potatoes – albeit more expensive – also increased to compensate for domestic shortages.

Figure 6: Higher percentage of production is needed to satisfy average use of frozen potatoes, 2010/11-2022/23



*Note: Five-year average of marketing year's frozen utilization divided by production.
Source: USDA NASS, Rabobank 2023

Figure 7: Increased imports of fresh and frozen potatoes eased domestic shortage, 2010/11-2022/23



*Note: Net position is the value of imports minus the value of exports.
Source: USDA NASS and GATS, Rabobank 2023

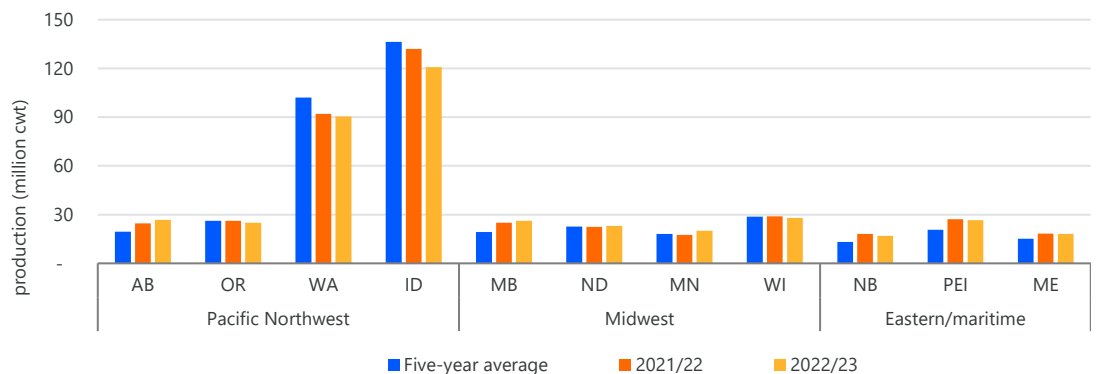
Conditions Are Ripe for Higher Contract Prices and Volumes

Strong open market prices and strong demand for frozen potatoes are typically sufficient reasons to raise contract prices. Processors regard strong open market prices as a signal of a high opportunity cost for growers, who have less incentive to switch from producing fresh potatoes for the open markets to producing processing potatoes under contract. Strong demand is considered a signal of healthy market conditions for increasing production of finished products.

In addition, heightened demand for potatoes produced under contract has gone unmet for two subsequent years. Contract prices, although up 20% to 25% YOY for the 2021/22 marketing year, were not high enough to clear the market, creating a supply deficit situation. Large fryers, such as McCain Foods, Lamb Weston, and J.R. Simplot Company, which increased processing capacity in the Pacific Northwest region prior to Covid-19, had to source raw potatoes from the eastern and

maritime regions to partially offset regional deficiencies (see Figure 8). This additional capacity is expected to be increasingly utilized in the near term, as demand for french fries and other frozen potato products has recovered to (or even beyond) pre-pandemic levels.

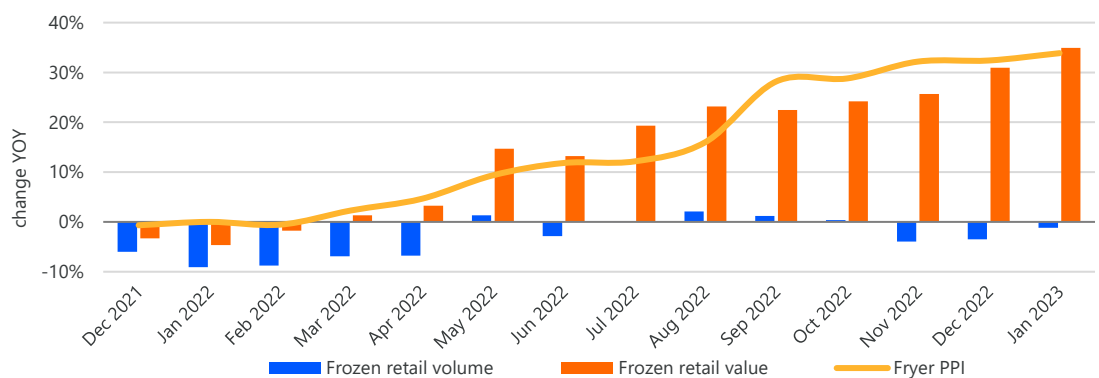
Figure 8: The significant drop in production in Pacific Northwest processing region is partially offset by sourcing inventories from other regions with a better supply situation, 2021/22-2022/23



Source: USDA NASS, StatCan, NAPMN, Rabobank 2023

Lastly, fryers have been able to pass on the increased cost of procuring raw potatoes to consumers in the retail channel with no loss of revenue (see Figure 9). Consumer purchases of frozen potatoes have proven to be minimally impacted by the increase in price, suggesting a case of inelastic demand, that is, consumers consider these products essential to their diet. Hence, the relative drop in volume is smaller than the relative increase in price. Anecdotal evidence suggests that consumers tend to stock minimally processed foods with long shelf lives as a means of maintaining a healthy diet while hedging against price inflation. This tendency has helped many frozen food categories, including frozen fries and other frozen potato products.

Figure 9: Fryers have already passed on the high cost of raw inventories to consumers with no loss in sales, Dec 2021-Jan 2023



Source: IRI, Macrobond, Rabobank 2023

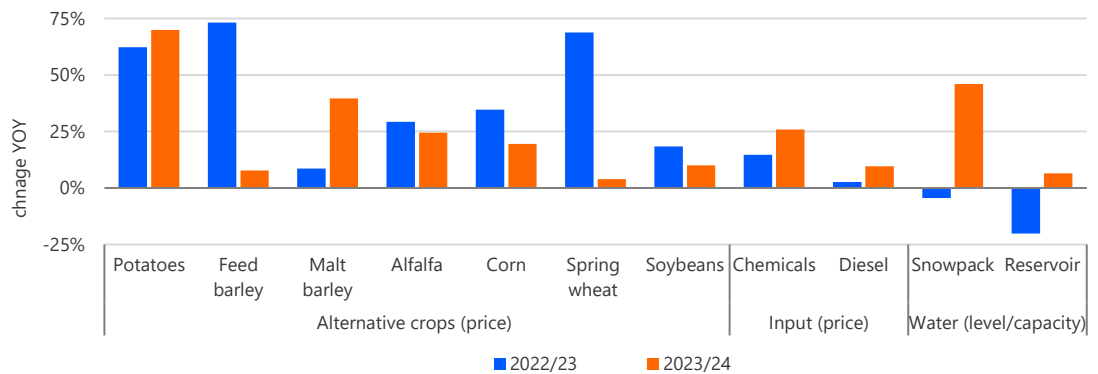
All of the above factors create a strong economic incentive for fryers to offer growers attractive contract terms to ensure an adequate supply of raw potatoes and to avoid costly idle capacity and lost retail sales revenue in such a high-demand environment.

Potato Acreage Expected To Increase

Historically, potato growers have expanded acreage in response to low production and strong prices. Since other factors such as non-price contract terms, input costs, prices of alternative crops, crop rotation, water constraints, and seed availability also play a role in determining planted area, the price-area relationship is highly variable. For the 2023/24 marketing year, potato planted area is expected to increase given competitive potato prices relative to alternative crops and an improved water outlook (see Figure 10). In addition, the negative impact on soils and the

increased risk of environmental stresses, such as the spread of weeds, pathogens, and nematodes, could force many growers not to repeat last year's crops this planting season. This means potato acreage that was lost to grains could be restored.

Figure 10: Competitive potato pricing and an improved water outlook in Idaho are expected to have a positive impact on potato acreage for the 2023/24 marketing year



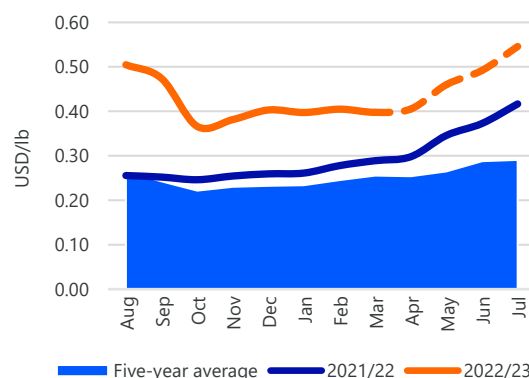
Source: USDA NASS, NRCS, National Water and Climate Center, Macrobond, Rabobank 2023

All things being equal, the acreage response to price alone would bring area for the 2023/24 marketing year to about 990,000 acres, a hefty 11% YOY increase. However, taking all other factors into consideration (in addition to trend), we expect potato area to increase about 2% YOY to about 915,000 acres.

Prices Will Soften but Remain Elevated

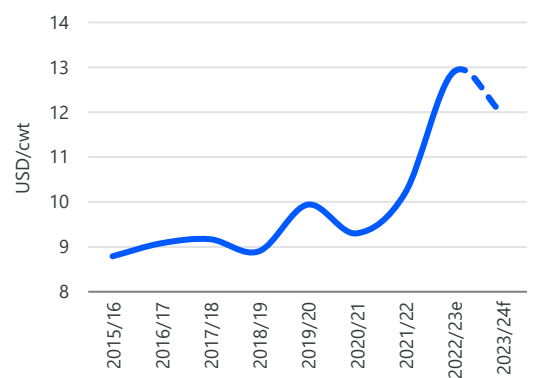
For the remainder of the 2022/23 marketing year, we expect prices to remain historically strong, particularly as we get closer to the end of the marketing year and before the beginning of the harvest of the new crop (see Figure 11). Assuming on-trend yields and the acreage response mentioned above, we expect the annual grower's price for all potatoes to drop 7% YOY (see Figure 12). Upside risk remains high as weather in most producing regions has been unseasonably cold, which typically delays planting and puts downward pressure on yields. Despite the projected drop, potato prices will still be considered high from a historical perspective.

Figure 11: The shipping-point open market fresh potato price will surge in the 2022/23 marketing year



Source: USDA AMS, Rabobank 2023

Figure 12: The season's average price for all potatoes is projected to drop in the 2023/24 marketing year



Source: USDA NASS, Rabobank 2023

Takeaways

The current marketing year has been a very good one for independent potato growers. On average, the price increase of open market potatoes is twice that of potatoes under contract. Will this improve growers' bargaining position when negotiating contracts for the 2023/24 marketing year? Fundamentally, the answer is yes. Grower cooperatives and/or associations that negotiate on behalf of potato growers can leverage the spread in price to improve contract price and terms. Growers ought to keep in mind, however, that record-high prices may not last for another year should a return to average yields and a >2% increase in planted area materialize. At that level of production, potato prices could potentially drop faster than unit costs, squeezing margins.

It is very likely that processors will be willing to pay higher contract prices this year, given the high opportunity costs processors face should they be unable to fully use their processing capacity to meet increasing foodservice orders and continued strong retail demand. Processors may also find that improving contract terms is a much more effective option to mitigate the risk and additional costs of relying on imports and/or supply from distant regions to secure their raw inventories.

Consumers are expected to continue paying record retail prices for their humble fresh and frozen potatoes, particularly russets, until a bountiful new crop hits the market. Despite the high prices, potatoes remain one of the few basic food categories for which consumers are willing to increase their per capita consumption when purchasing power is weakened.

In a nutshell, potatoes have been scarce and expensive, but they remain highly sought-after.

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