Talking Points: Consumers in Perspective

The Views From My Colleagues

RaboResearch
Food & Agribusiness
far.rabobank.com

Nicholas Fereday
Executive Director
+1 347 215 4158

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Summary

In this summer edition, we draw largely from the published work and commentary of my colleagues at Rabobank who specialize in a range of areas from beef to beverages and everything in between. Although writing about different areas of the food system, the impact of and on the consumer is omnipresent.

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1. The Return of Inflation: Transitory or Permanent?

Given all the media headlines, how could we not start with a discussion on the return of inflation "after decades of slumber?" In the US, the latest data of the consumer price index (CPI), a common inflation metric, for May came in just shy of 5%. That's the highest level we have seen since 2008. When the more volatile components such as energy and food prices are removed, this "core inflation" rate was almost 4%, close to a three-decade high.

The big question here, as my colleague Christian Lawrence never tires of saying, is: "Will it be transitory or persistent?" This is the macroeconomic equivalent to the question my teammates and I have been debating in the food space: "What's gonna stick?" As Christian relates, there are arguments on both sides. Take transitory drivers. Looking at the month-on-month CPI changes over the last two months, a full one-third has been down to just one component of the CPI – used car sales. This is the result of the slowdown in new car production (itself a function of supply chain disruptions through the pandemic as well as people avoiding public transport.) These temporary, hard-to-avoid mismatches are exactly the examples that the Federal Reserve and others use to argue the current bout of higher inflation will be short-lived and is to be expected as the economy reopens. After all, having largely shut down the USD 23 trillion dollar economy, isn't it reasonable to expect a few inflationary hiccups during its reboot? And in the 'persistent' camp are arguments around pent-up demand, wage pressures, and (closer to home) higher commodity prices (see later).

Whether the current high levels of inflation will be sticky is also picked up in Rabobank's report, *A Structural Inflation Outlook: Whipping Inflation into (a New) Shape?* by Michael Every, Elwin de Groot, and Philip Marey. So, which is it? In a wonderful acknowledgement of the limitations of forecasting, the team confesses, "The problem is, we seem universally incapable of answering it by forecasting inflation correctly!" because "there is no one accepted, robust theory of how inflation actually works." My colleagues are in good company with their honesty about the murkiness of their crystal balls. At the start of June, Federal Reserve Chairman Powell commented, "This is an extraordinarily unusual time, and we really don't have a template of any experiences of a situation like this. We have to be humble about our ability to understand the data." Nevertheless, recognizing that inflation is a "multi-faceted, multi-disciplinary, structural phenomenon," the report's authors write about the eight most important structural factors, including tight Covid-related supply chain logistics, the monetary policy stance of the Federal Reserve, and the Federal government's trillion dollar stimuli, that have "huge potential inflation consequences" and are currently driving inflation, as well as the rally in commodity prices.

On this last factor, my London-based colleagues Carlos Mera and Andrew Rawlings noted in their article, *Food Price Surge Is Unlikely to Revert*, that agricultural commodities have already been rising for over a year. For example, the S&P Global Agri Commodity index has been rising since last summer. It was at its highest level in almost a decade in mid-May (461 on May 10) and has since fallen back to 385 (June 25), but this is still at a level not seen since 2014. In their article, the authors identified four major factors that will still have an impact this year: a weaker US dollar, La Niña weather events, strong global demand, and speculation. On the last two points, commodities have been one of the best-performing asset classes year-to-date, and there has been "outstanding import demand" in agricultural imports from countries such as China, where year-to-date soybean volumes are up 36% over May 2019 volumes, wheat is up 262%, corn 339%, barley 80%, and edible oils 76%, which, if this continues, is "clearly inflationary for the rest of the world."

Given all of this, it is not surprising that food companies have been talking about input cost inflation (packaging, agricultural commodities, transport, etc.) and the squeeze it will have on their margins for some time. Back in February at the CAGNY conference, inflation was already on everyone's mind, and executives were soothing their shareholders' fears with calming words about their inflation mitigation tools, such as hedging their main input costs and productivity gains to lower their production costs and, where possible, "take pricing." The latter is all about passing costs onto consumers through higher prices or playing around with the "price-pack architecture" (such as keeping the price the same but making the product smaller). This last strategy is, of course, not without risk. Not only do they have to persuade the retailers to play ball, but they also have to hope there isn't too big a hit on demand (consumer demand for premium brands is, and there's that word again, stickier) that chokes off the elevated growth they have been enjoying during the pandemic.

2. OJ Consumption: We've Been Here Before

Moving on to the orange juice (OJ) market, which also enjoyed a spike in demand, the outlook – unlike the future path of inflation – is much clearer because, in a sense, the industry has been here before. My São Paulo-based colleague, Andrés Padilla, argues in his report, *Global Orange Juice Outlook 2021/22*, that the market has, like many other supermarket categories, "Performed well during the pandemic, with stronger sales helping to lift overall demand in the US and other developed markets." The two main demand drivers are very familiar to the food world: "Stronger consumption at home and consumers' health concerns during the Covid-19 outbreak."

Like soda, OJ consumption has been in decline since the start of the century, losing out to growing reduced-calorie competition from other beverages, such as coffee, tea, energy drinks, and, of course, bottled water, and made worse as "beverage companies focused on high-growth products to the detriment of mature ones such as orange juice." But just like canned soup and breakfast cereal sales, the pandemic changed all that as consumers looked to OJ for their vitamin C to help ward off the virus (a serving of OJ contains the recommended daily amount of vitamin C). The lockdowns and transition to working from home also meant more breakfasts at home, which was also good news for juice (in more normal times, two-thirds of OJ is consumed at breakfast in the US). These demand drivers caused such a rally in OJ prices at the start of the pandemic it became one of top-performing traded commodities in first three months of 2020.

Unfortunately for the industry, many of these new demand drivers are already looking transitory, and growth rates have begun to diminish as the lockdowns eased. As Andrés notes, "The retail sales behavior suggests that retail juice demand gained during the pandemic due to temporary factors like lockdowns and health concerns rather than more permanent, longer-term shifts that could revitalize orange juice sales." When coupled with the fact that foodservice sales shrank significantly in most markets, he concludes that despite the working-from-home trend sticking, "a return to some sense of normality after vaccinations will likely mean converging back to the long-term trend of gradually declining orange juice consumption in mature markets." Recent history backs up Andrés's analysis here. Particularly bad winter flu seasons (such as in 2018) or past epidemics (swine flu in 2009) led to a temporary surge in OJ sales only to see them revert back to a long-term declining trend (per capital OJ consumption in the US peaked in 1998 at 5.6 gallons and has been on a downward slide ever since).

3. Hard Seltzer: A Truly Exceptional Story

The impact of consumers' changing preference for reduced-calorie offerings is not limited to the OJ market but is a common theme across the food and beverage world. It is a critical factor discussed by my colleagues Sudip Sinha, Francois Sonneville, and Jim Watson in their review of the hard seltzer market in *Beer Quarterly Q1 2021: The Rise of Hard Seltzers in the US and Beyond.* In the US, the growth of hard seltzer has been stellar, stealing almost 10% of the beer segment in just five years, with about USD 4bn in sales. From a food company perspective, this is a fascinating story about calories, cans, convenience, and community-building, but let me constrain myself to a few observations of particular relevance:

1. **It's not about beer; it's about the drinking occasion.** First, why are they even writing about alcoholic fizzy water in a beer note? (OK, the flippant riposte is too obvious....) Seriously though, beer, or more correctly the drinking occasion(s) previously dominated by beer, is a casualty of this new rapidly growing market. Not wishing to be left out of the pool party, the beer companies whose mainstays have been losing out to lower-alcohol, lower-calorie options for years are keen to diversify into other brewed beverages. They have jumped into this market to the point where "every player in the US beer space has major plans for new products in 2021."
2. **There are still unmet mainstream needs, especially for Gen Z.** Breaking news, not everyone likes beer. Doubly so if the branding is a turnoff. As my colleagues note, hard seltzer is a cheaper "entry-level alcohol to folk who don't like beer." Its light flavors, appealing refreshing taste, and gender-neutral marketing make it "easy-drinking and very accessible," especially to Gen Z. One only has to look at how the products exploded on social media (which oftentimes had very little to do with brand marketing) to appreciate these products never intended to be a niche craft-like market but very mainstream, very "meme-able," and universal.
3. **No one wants to drink their calories.** Similar to Michael Pollan's mantra to avoid food products with more than five ingredients, "Don't drink your calories" is an equally pervasive theme in the beverage world as people continue to look for healthier alternatives. Just as bottled water (the largest beverage category) and sparkling waters (seltzers) like Spindrift and La Croix have rapidly taken market share and drinking occasions from soda and juice, hard seltzer has built on that popularity and applied it to devastating effect in the alcohol space as it "builds on the existing trend toward ever-lighter beers with its light flavors." Although the FDA forbids companies from making health claims about alcohol-containing products, from a food lens, we can see the parallels with the better-for-you trend of health-conscious shoppers.
4. **Canned convenience.** Building on that last point, there is just so much for food companies to be inspired by here! How can you not be excited and intrigued by a new category addressing an unmet mainstream need that is premium but still cheap, appeals to the health-conscious consumer, is clean label, single-serve canned convenience (literally sold in your local convenience store), with a meme-driven marketing campaign run by your consumers that has

even persuaded Coca-Cola to join the party (their first alcoholic drink in the US in four decades). Is it any wonder that Kraft Heinz has appointed Sanjiv Gajiwala, the chap responsible for brand marketing at White Claw, to be their new Chief Growth Officer?

4. The Risks of Recovery for US Beef Demand

Earlier this year, my colleague Dustin Aherin sifted through the factors driving beef demand during the initial stages of the pandemic in his report, *US Beef Demand: The Risk of Recovery.* Often lost in all the frothy commentary and headline domination around meat alternatives and all things plant-based, Dustin reminds us that there has been "incredible strength" in the demand for beef during the pandemic but at the same time warns, "The exact circumstances that fostered beef demand's incredible strength during the pandemic also foretell potential vulnerabilities during the post-pandemic recovery." Some of those early demand drivers Dustin notes include:

- **A successful pivot.** "The beef supply chain was able to shift distribution logistics from foodservice to retail at an astounding pace." This rapid switch to retail helped to offset the decline in demand for steaks at restaurants and to meet the rise in greater at-home demand driven by a "food-stockpiling mentality" as well as more grilling opportunities as the number of home-cooked meals that included meat or poultry increased from about four to almost five per week.
- **Rising consumer income.** Just like the packaged food industry, beef demand was a beneficiary of rising disposable per capita income thanks to the government's fiscal stimulus. Compared to the start of 2020, average consumer incomes rose by 4.4% from March to November "despite economic collapse generating the worst recession since the Great Depression."

But as assistance programs are wound down and our lifestyles readjust, what will happen to beef demand? Dustin warns the industry to avoid the complacency trap as "Strong pandemic beef demand does not guarantee strong demand in the future" and "Reduced income reduces beef demand, all else being equal." The revival of full-service restaurants will also be critical to beef demand post-pandemic, and "If the full-service restaurant industry doesn't recover at the same pace as our daily lives, beef demand, particularly middle meats, could be at risk." And on the retail side, as daily life "more closely resembles the fast-paced, pre-pandemic norm," the report's arguments suggest that "retail beef demand could retreat to pre-pandemic levels by Q4 2021."

Once again, we come back to the stickiness issue, and Dustin's more recent comments to me on the beef industry will clearly resonate with a wider audience: "All in all, I think beef demand will take a step back toward normalization once we get through the major shocks of shutdown, stimulus, and reopening, but there will be some stickiness to new tastes and beef-eating habits."

5. Consumer-Led Changes Across the Food Industry

Let's wrap up with some brief highlights from other great reports:

- In *A Reduced-Methane Future for Dairy*, Ben Laine kicks off by recognizing that consumers' concerns are leading to a change in farming practices. "Consumers are demanding environmentally sustainable food production in a more developed and nuanced way." Leading dairy companies such as Nestle, Danone, and Dairy Farmers of America have responded to consumers' demands for transparency with more "measurable efforts toward reducing environmental impact." The report cites statistics that sustainability-marketed milk sales grew more than 20% from 2013 to 2018 compared to negative growth for the category as a whole. And even in growth categories like yogurt and cheese, their sustainability-marketed counterparts grew two to three times as fast.

- Continuing with the theme of consumers' environmental concerns, Susan Hansen writes of the efforts of "the usual brand owners" in her report, *What Does Advanced Recycling Have in Store? Ten Key Learnings of the Latest Global Trends.* In response to the "strong push from society to solve the growing problem of plastic packaging waste" major food and beverage companies have adopted a variety of strategies and tools to target the recyclability (and recycled content) of their plastic packaging, as in the case of Mars, which is moving toward 100% reusable, recyclable, or compostable packaging by 2025. And in order to ensure feedstock to reach these targets, companies are engaging in recycling projects too "via offtake arrangements, collaborations to develop technology, or even equity stakes," such as Nestlé (among others) partnering with UK-based Recycling Technologies.
- According to the data given in a recent presentation by David Magaña entitled, *A Glance Into the Future of Fresh Produce Markets,* the fresh produce department, like most supermarket aisles, was on fire last year with year-on-year dollar sales running about 10% higher (13% for fresh vegetables, 7% for fresh fruit). Interestingly, consumers have become more comfortable shopping for fresh fruit and vegetables online. Where once it was assumed consumers wanted to see, feel, and squeeze their produce before buying, this is no longer considered an impediment. But what does matter for fresh produce (and for a few other supermarket categories) and what does drive demand is "healthiness, taste, and convenience."
- Pablo Sherwell's and Mario Alfonso's report, *The North American Sugar Market: 2021-2030. A Sweet and Sour Outlook,* paints a familiar story (we've already heard it with OJ) of the impact of changing consumer preferences. For sugar, the outlook remains unchanged by the pandemic as "US and Mexican per capita sugar consumption will continue to weaken as a result of changes in consumer preferences, habits, and diets and the ongoing impact of public policies (i.e. sugar taxes and food & beverage labeling)."
- And finally, let's stick a pin in the topic covered by my colleague Chia-Kai Kang in "*Gene-Editing Technology to Disrupt Food & Agri Systems*. As she notes, "the impact of gene-editing technology on our world is tremendous," but I'm left wondering how the benefits of this technology will be communicated to consumers and whether the conversation will go the way of GMOs. As Charlie Arnot from the Center for Food Integrity argues, when communicating with consumers about food production, shared values are many times more important than facts, reminding us to avoid the pitfalls of the GM debate in order to "capture the enormous potential of gene editing to do good in the world."

Imprint

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Nicholas Fereday	Executive Director	nicholas.fereday@rabobank.com +1 347 215 4158