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Mar 2019

# GLOBAL FOOD
## COMMODITY UPDATE

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The geopolitical landscape of 2018 was one marked with tensions, barriers and protectionism.

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Environmental factors play a major part in the commodity world.

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As agriculture becomes ever more mechanized, the price of crude oil underlines input costs in almost every agricultural sector.

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# Data Coverage

## Price data on exchange traded commodities is just the tip of the iceberg

Grains

Metals

Sugar

Oil

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Meat

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# GEO-POLITICAL

**The geopolitical landscape of 2018 was one marked with tensions, barriers and protectionism. The protectionist policies implemented by major trading nations around the globe caused the dynamics of the food commodity world to change.**

**The US-China trade war, ignited by President Trump's widespread import tariff policy, and Brexit have been two major geopolitical events inspired by protectionism that have had significant impact on food pricing and trade. In light of this, tensions, barriers and protectionism also breed new opportunities by shifting trade routes and forming new partnerships, the US-Mexico-Canada-Agreement (USMCA) is just one example of this. Here, Mintec takes a look at the geopolitical events which will continue to affect us going into 2019.**

## Brexit's impact on EU trade

Brexit remains a hot topic throughout the UK and Europe and despite the UK's departure from the EU yet to be actioned, the topic has still raised questions and uncertainties over UK and EU food commodities.

The UK, as a member of the EU, has tariff free access to the EU single market. However, dependent on the deal the UK reaches with the EU, if one at all, this could all change. One possibility if no deal is reached is that the UK must abide by World Trade Organisation (WTO) rules. This would incur tariff hikes on food commodities thereby having a knock-on effect on UK-EU trade. Raised tariffs could see price rises and reduced EU-UK trade. For example, 16% of UK dairy is imported with 98% of those imports coming from the EU. If tariffs were to be raised, then these dairy products could rise substantially in price until the UK became self-sufficient or found alternative sources to replace EU dairy. This could open up opportunities for UK dairy producers to expand their facilities or new trade routes and partnerships to be formed. Alternatively, the UK and EU may establish and formalise a trade deal by March in which case UK-EU trade may continue to operate according to the terms of the deal founded.

The single market also grants frictionless trade with the EU. Leaving the single market would facilitate the need for customs declarations on the border for all UK-EU trade. These border checks that would be needed for the trade of food commodities could cause delays and raise transportation times substantially as the UK's customs declaration services is designed to handle 150 million declarations per year, whereas post-Brexit, this could increase to over 250 million. The added costs of these delays, especially for those food industries reliant on just-in-time production for fresh food, could raise food prices.

Furthermore, Brexit could spell the reduction of EU migrant workers eligible to work in the UK. Industries such as the Scottish salmon industry, Scotland's second largest food and drink export industry behind whiskey, are reliant on EU migrant workers in the processing and distribution aspects. Limiting the labour force could impact these industries by rising labour wages and reducing the workforce.
The UK is due to have a deal in place over Brexit by the 29th March 2019 and the deal arranged, or not arranged in the case of a "no deal" Brexit, will determine whether the UK will remain in the single market or whether the UK will be adopting WTO tariff rules.

> "Brexit could spell the reduction of EU migrant workers eligible to work in the UK.

# Trade Wars between US & China

The US-China trade war continues to have a defining impact on the world of food commodities.

Starting with US tariffs on Chinese steel and aluminium in March 2018, trade tensions soon descended into a series of tariffs and retaliatory tariffs on a vast quantity of goods, including f ood commodities.

An example of the agricultural impact can be seen in US-China soybean trade. China is the number one importer of US soybean due to soybean being the main content in pig feed and China's need to feed their huge domestic pig population. 25% tariffs on US soybean encouraged Chinese importers to reduce their reliance on the US to avoid these high costs. Consequently, they turned their attention elsewhere, predominately towards Brazilian exporters. However, imports from Brazil, and elsewhere, are not sufficient. As a result, farmers in Brazil and Argentina have been planting record crops for the 2018/19 season.

In the meantime, some Chinese pig farmers have altered the content of their feed with cheaper protein replacements such as rapeseed and yellow peas.

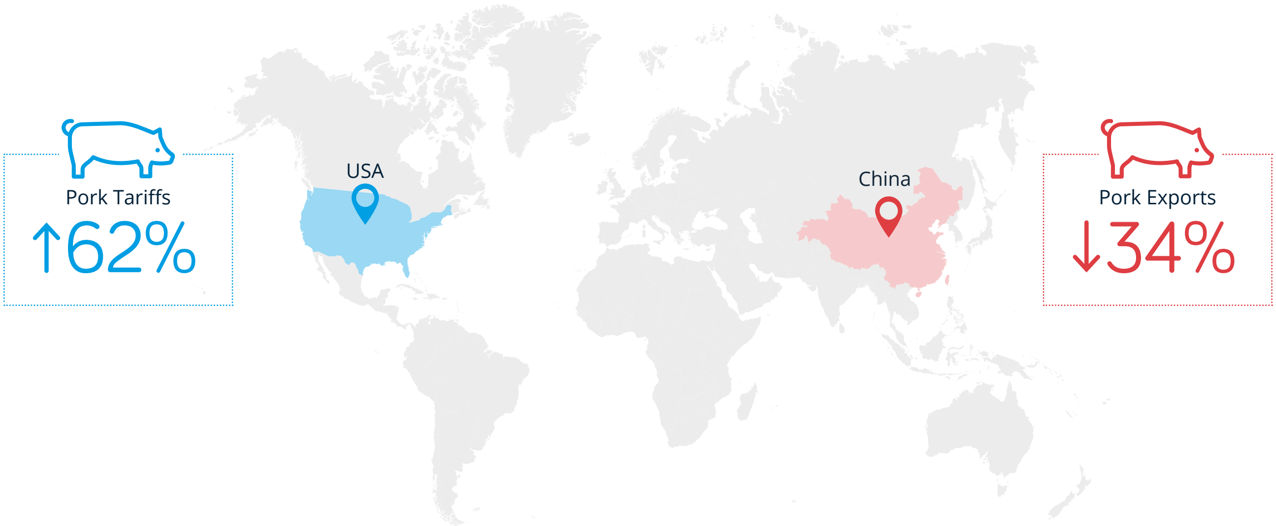
> "US rank third on the list of pork suppliers to China, behind the EU and Canada.

Similarly, China are the world's biggest producer, importer and consumer of pork and so when tariffs on US pork were raised to 62% in July 2018, the repercussions on global pork trade were inevitable. China consume the majority of what they produce and so there is also a need to import.

The US rank third on the list of pork suppliers to China, behind the EU and Canada. Between April and September 2018, after the tariffs were implemented, US pork exports to China fell 34% y-o-y. This left a supply glut of unsold pork in US cold storage which weighed down on US pork prices towards the end of 2018. Again, China turned to alternative supplies with Brazil, Spain and Germany all experiencing a boost in sales as a result.

Negotiations between Chinese President Xi Jinping and US President Donald Trump restarted in 2019 as both administrations look to resolve the trade war and strike a deal before a deadline set on March 2nd 2019.

The conclusion of these talks will either see normal trade relations resumed between the two economies or, should no deal be agreed, a continuation of shifting trade routes and the building of new partnerships altering the face of global food trade.




# New Partnerships in US trade

What we've learnt in 2018 is that trade barriers can be the birthplace for new opportunities and new relationships.

After the US implemented widespread tariffs on Mexico and Canada, and retaliatory tariffs were sent back in response, negotiations began between the three nations to build a new partnership. The outcome was an updated version of the NAFTA agreement, now called the United States-Mexico-Canada Agreement (USMCA). The USMCA ensures preferential access for US agricultural exporters to the Mexican and Canadian markets while protecting Mexico and Canada from future US tariffs on car imports. As part of the deal, Canada opened its dairy market for US produce by expanding its quota for US dairy from 3.25% to 3.6%. Whilst this might seem minimal, it equates to $70 million worth of trade. Similarly, and despite already being the number one supplier of maize to Mexico, the US gained a further advantage through the USMCA which has given the US an edge over competing suppliers Brazil and Ukraine.

> "The outcome was an updated version of the NAFTA agreement, now called the United States-Mexico-Canada Agreement (USMCA)

Also involving Canada and Mexico, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) was also ratified in 2018. New Zealand, Japan, Canada, Singapore, Mexico, Australia, Vietnam, Malaysia, Chile, Peru and Brunei Darussalam are the eleven member states of the CPTPP and the pact has liberalised trade between these members by cutting tariffs and giving greater access to one another's markets. The pact includes an unprecedented trade relationship between the Australian economy and those of Canada and Mexico with Australian exporters of grains, sugar, beef, pork, wheat and barley set to benefit from new and lucrative markets.

# WEATHER & ENVIRONMENTAL

**Environmental factors play a major part in the commodity world, in particular the agricultural sector, which is impacted by severe weather conditions and diseases. Many adverse environmental conditions were seen in 2018, which had a detrimental impact on the growth and productivity of various crops across the globe.**

## Heatwave & droughts affecting crops

Heatwaves and droughts are an occurring problem, affecting most countries around the world and driving the **agricultural** commodities market.

Nearly 56% of the US was abnormally dry in the summer of 2018 and more than 8% of the country saw extreme drought conditions. The drought affected crops, such as maize; which consequently impacted subsidiary markets such as cattle feed. Argentina also had the worst drought in years during autumn 2018. Argentina's meat and dairy industries depend on corn and soymeal for animal feed; however, adverse climatic conditions have caused an estimated loss of $600 million in 2018.

The European market was also hugely affected by heatwaves and droughts during the summer and autumn 2018.
Since 1976, 2018 was one of the hottest and driest summers in Europe on record. European crops underwent environmental turmoil with the arrival of heatwaves and droughts, decreasing the productivity of the plants to record levels. Vegetables like onions, potatoes, and carrots were severely affected.

The following effects were seen on various agricultural commodities:

- Smaller sized carrots and onions were harvested across the EU causing the yields to drop by 30-40% y-o-y and 25% y-o-y in 2018.
- Secondary growth in potatoes, a distortion that led to a loss in harvest.
- European wheat production forecast down, 9% y-o-y in 2018/19 as the crop dried in fields.
- Rapeseed production and oil productivity also dropped.

> **Nearly 56% of the US was abnormally dry in the summer of 2018 and more than 8% of the country saw extreme drought conditions.**

In the rest of the world, Australia – one of the leading wheat exporters - has had reduced crops in 2018/19 due to extreme droughts.

Australian wheat exports are projected down 25% y-o-y for 2018/19, the lowest in a decade. Similarly, barley yields have also been impacted with production being forecast down 18% y-o-y for 2018/19. In addition, India had drier than normal conditions in the monsoon 2018 and more than 37% regions in India were declared as drought prone. India is one of the largest producers of onions and the plantation of onions for 2018/19 season is estimated to be down 12-15% y-o-y.

Following adverse weather throughout 2018, the weather in 2019 is estimated to be one of the warmest on records. As a result, farmers are expected to sow less to avoid losses caused by the heat and planted areas are likely to reduce across the globe.

## El Niño & agriculture

An El Niño is a natural weather phenomenon associated with Southern Oscillations and refers to a cycle of warm and cold temperatures.

During El Niño, the surface waters in the central and eastern Pacific Ocean become significantly warmer than usual. El Niño is accompanied by high air pressure in the Western Pacific and low air pressure in the Eastern Pacific.

If the El Niño causes unpredictable weather, it tends to bring heavy rains to southern regions of South America and extreme droughts around the western Pacific. Therefore, due to its diversity, the effects of El Niño impact many cereal crops.

South American countries such as Argentina and Brazil are significant contributors to various commodity markets. The impact of heavy rainfall around this area is most likely to see crops; such as maize and wheat, have their quality affected, resulting in a likely price rise. Colombia, one of the top players in the banana market, is expected to receive 80% lesser rainfall in Q1 of 2019 if the El Niño weather phenomenon occurs.

According to the latest updates from the World Meteorological Organization, there is a 75-80% chance of occurrence of an El Niño during February 2019.

> **75-80% chance of occurrence of an El Niño during February 2019**

# Preventing diseases in crops

Diseases have always been one of the crucial factors driving the agricultural sector, particularly livestock, fruit and vegetable commodities.

Since August 2018, African Swine Fever (ASF) has been contaminating multiple Chinese farms and has since been detected in Western Europe in Belgium. The outbreak could have significant implications on EU pork trade and production, should ASF spread to export-heavy nations like France and Germany. Action has been taken to prevent this from happening. A containment perimeter was set up around the infected zone while Belgian authorities sanctified the culling of over 4000 domestic pigs spanning over 58 farms. Belgian pig farmers are also receiving combined national and EU compensation.

Lastly, ASF is also likely to affect the demand for pork and poultry, and livestock producers would have to prioritise biosecurity.

Moreover, consumer demand shift from pork to beef and seafood is a trend to look out for in 2019.

In November 2018, the Centre for Disease Control and Prevention issued a US national ban on romaine lettuce due to an E. coli contamination. Following the outbreak of E.coli, there were two effects seen in the market: a decreased supply of romaine lettuce and an increased demand for alternative lettuce varieties in the market. Romaine lettuce accounts for approximately 38% of the total US lettuce category production, so reduced supplies have left a hole in the market.

Demand has increased for other lettuce varieties as a substitute, with the main one being iceberg lettuce; other alternatives include Boston, red leaf and green leaf.

Efforts have been made in different ways to keep plants safe from these diseases and will continue to improve in 2019. Some of the countries have allocated grants and subsidies to compensate for losses or to improve the measures to control the diseases. For example, the University of Florida received a grant from USDA of USD 3.5 million in 2018 to be utilised for growing and protecting fresh grapefruit trees inside 14 feet high screen houses. The grapefruit industry in Florida has been suffering from the citrus greening disease.

> “In November 2018, the Centre for Disease Control and Prevention issued a US national ban on romaine lettuce due to an E. coli contamination

# CONSUMER TRENDS

Consumer trends are a major driver of food commodity prices. Below we discuss the major trends that are influencing consumers' purchasing decisions at supermarket tills.

## Increase in veganism by consumers

Veganism is a growing trend with some consumers looking to eradicate meat and animal-based products from their diets due to ethical, health and environmental reasons.

The strong demand for non-meat food has seen the rise of vegan proteins in 2018 – and we can expect this to continue in 2019. Sales of meat-free foods have increased 22% between 2013 and 2018 and this consumer interest has resulted in 34% of meat eaters reducing their meat consumption in 2018.

Younger consumers, aged 25 - 34, were the most likely (40%) to have reduced their meat consumption in the last year.

This trend has impacted the meat and livestock industry which has had its growth curbed as consumers become more conscious about the environment and their health. For example, plant-based meat sales in the US increased 24% this year whereas animal meat sales grew by just 2%.

> "US dairy farmers have been petitioning to the Food and Drug Administration (FDA) for plant-based milk products to cease using the term "milk" since plant-based milks are not produced by mammals.

This consumer trend certainly poses a threat to the meat and dairy industry with plant-based proteins, for example those made of soybean, and milk alternatives such as oat and soy milk, growing in popularity.
In response to this consumer trend, there has been a fight back from the dairy industry that is just one of a number of conflicts between animal-based and vegan industries. US dairy farmers have been petitioning to the Food and Drug Administration (FDA) for plant-based milk products to cease using the term "milk" since plant-based milks are not produced by mammals. US dairy farmers have been facing financial pressure as milk has been losing popularity in the face of plant-based milks which made it into one-third of US households in 2016. An FDA ruling is hoped for by dairy producers who feel that new labelling requirements would benefit milk producers by protecting their product.

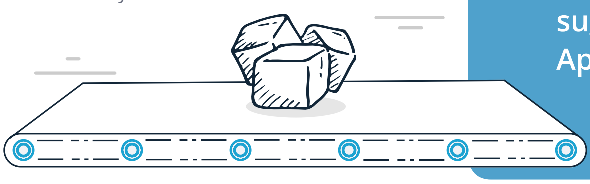
## W.H.O recommends a sugar tax

Sugar consumption has become a concern, not just in the UK but globally. Reports are now showing that 62% of adults in the UK are obese.

This has put pressure on medical costs as obesity is linked with a variety of health issues. Consequently, the World Health Organisation has recommended a sugar tax, with the UK introducing the sugar tax on the 6th April 2018. This introduction has already led to many manufacturers dramatically reducing their sugar content.

Despite the introduction of the sugar tax, EU sugar consumption forecasts for 2018/19 are set to remain stable at only 1% above the 5-year average, 3% above the 10-year and 2% above the 20-year average.

The stability in the usage of sugar is due to wide availability of the commodity and because of sugar's substantial practicality in food manufacturing. Global sugar stocks remain high as production continues to outweigh overall demand. Production is expected to fall during 2018/19 but this remains 5% higher than expected consumption and ending stocks are reported up 14% in 2018/19 when compared to the previous 5-year average. The years of surplus in the market place have led to high ending stocks and low prices for manufacturers. Low sugar prices have allowed manufacturers to easily absorb the sugar tax leaving their customers widely unaffected.



> "Consequently, the World Health Organisation has recommended a sugar tax, with the UK introducing the sugar tax on the 6th April 2018.

# Impact of palm oil agriculture

As people are becoming more aware and proactive over the environmental impact of their consumption, they are demanding alternative products.

Palm oil is one of those which was significantly highlighted in the headlines throughout 2018 and is likely to continue throughout 2019. In 2018, the supermarket Iceland banned palm oil from their own brand products driven by consumers' concerns of the deforestation taking place in Malaysia and Indonesia to produce the oil.

In addition, Iceland released a Christmas advert highlighting the issues of palm oil, but it was banned on the grounds of political advertising, yet it was still viewed over 60 million times online via various social media sites.

This fact emphasises the increase in consumer awareness, and the power of social media in amplifying the voice of the consumer.
What impact, if any, has the consumer had on palm oil? Despite efforts, the area harvested continues to increase coming into 2018/19, up 10% when compared to the 5-year average. Meanwhile, global demand is also increasing in 2018/19, 15% higher than the 5-year average.

However, laws are being reviewed, and during 2018, the EU announced a ban on palm oil in their biofuel by 2020. Whilst this can be considered a positive step for activists concerned about deforestation, it remains to be seen in 2019 whether overall production and demand for palm oil will decrease.

GLOBAL PALM OIL DEMAND

↑15%

# Crude Oil & Currency Fluctuations

As agriculture becomes ever more mechanized, the price of crude oil underlines input costs in almost every agricultural sector. Furthermore, with the extended use of biodiesel and bioethanol, even stronger relationships have been established between the energy markets and the commodity markets.

Crude oil prices impact almost everything; from plastics where the crude oil directly impacts intermediate production feedstocks, through to vegetable oils and cherries where crude oil fluctuations will impact air freight costs.

In the currency markets, Brazil and Turkey, two major agri-exporters, saw heavy fluctuations in 2018 in real and lira respectively and question marks remain over the future direction of their respective currencies. While the decline in both real and lira has been a welcome sign for global importers, the domestic economies have been facing bleaker prospects through higher import costs, rising inflation and interest rate hikes.

## Rising crude oil prices

Crude oil prices experienced a roller coaster year in 2018.

Prices rose steadily through the year and peaked in early October where the markets reached heights not seen since 2014. Behind the price increases were the US sanctions on Iranian oil exports which were imposed on the country due to its nuclear program.

However, after the October heights, crude oil prices fell sharply due to mass US oil production from shale wells. US output in 2018 reached and exceeded the peak US oil production from the 1970s thanks to technological advances boosting the efficiency of US shale drillers. This soaring output has weighed down on global prices while OPEC did not curb any output.

This changed in December as OPEC members and Russia agreed to cut crude oil production by 1.2 million barrels a day which has since seen prices rise through December and into early 2019.

Looking ahead, weak oil prices are expected in 2019 due to global production oversupply. However, the 2019 oil markets will largely depend on the decisions of OPEC members and if further production cuts are agreed, prices could strengthen again.

> "Crude oil prices fell sharply due to mass US oil production from shale wells

RUSSIA AGREED TO CUT CRUDE OIL PRODUCTION BY

**1.2 MILLION**

BARRELS A DAY

# Brazilian real lowers sugar & coffee prices

For most of 2018, the value of the **Brazilian real** was falling against the dollar, driven by a mix of political turmoil and uncertainty, aggravated by the arrest of the ex-president Lula, and the unpredictable outcome of presidential elections.

A weaker currency has helped Brazilian exporters to remain profitable and gain an advantage on exports of soyabeans for instance, especially since China's retaliatory tariffs on the US soybeans. The depreciation of real has also driven prices lower for sugar and coffee, for which Brazil is the main global supplier. Arabica coffee prices on the ICE US dropped to its lowest level in a decade in September last year.

However, since October, the real has appreciated, buoyed by the election of Jair Bolsonaro for the new president of Brazil. The far-right former army captain has vowed to introduce reforms to tackle crime and step up privatizations.
What are the likely scenarios for the Brazilian real in 2019?

The market is being optimistic about the value of real, mainly due to Jair Bolsonaro's promises of reforming the Brazilian economy. Therefore, it is likely that real will continue to advance, at least in the first quarter of 2019.

The development of real in the second half of 2019 will to a large extent depend on the government's success in implementing its policy changes, while other political matters such as the progress of the US-China trade negotiations may also affect the currency.

> " The depreciation of real has also driven prices lower for sugar and coffee, for which Brazil is the main global supplier


# The unprecedented fall of the Turkish Lira currency

Turkey is a major exporter in various agri-food sectors such as cherries, sultanas, dried apricots or hazelnuts and until recently, global importers have benefited from favourable prices for Turkish goods and services following the unprecedented fall in Turkish lira.

Turkish lira had lost almost half of its value between August 2017 and August 2018, making it one of the worst performing currencies in 2017/18. The lira had fallen on a mix of political instability and a lack of confidence in Turkey's economic growth and reforms, while being further exacerbated by the deteriorating relationship with the US.

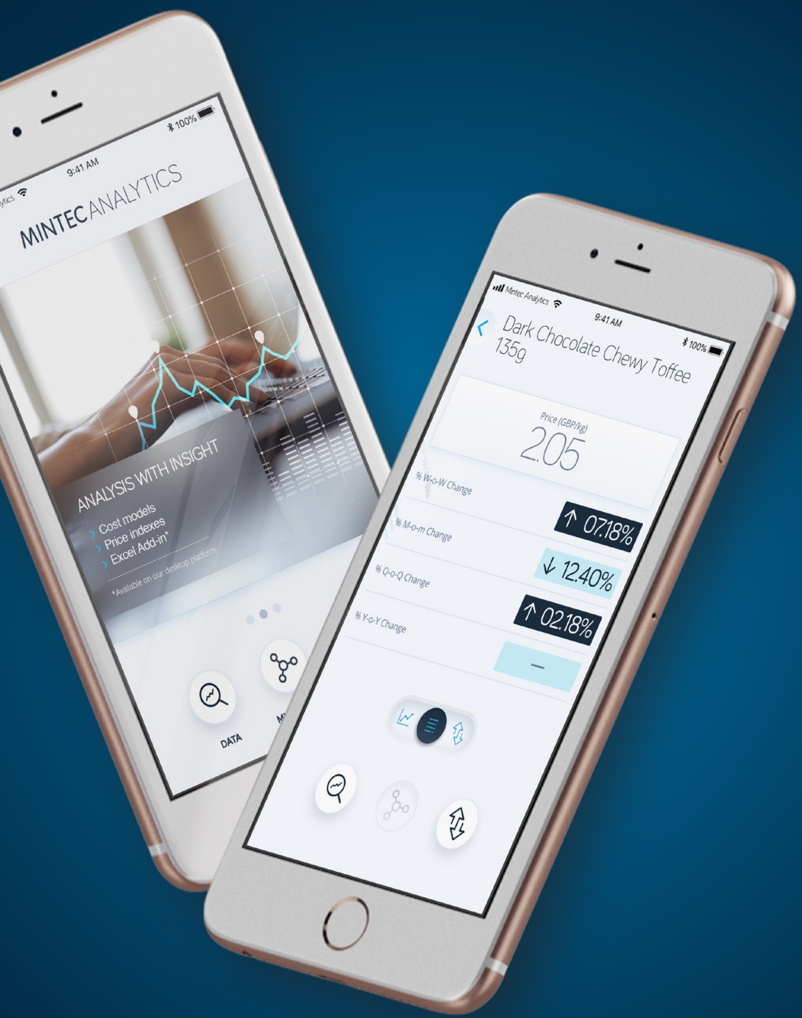
Since August last year, the lira has recuperated some of its value, driven by an improved Washington-Ankara relationship and changes in Turkish monetary policies.

Nevertheless, the recovery in the lira might have been short-lived and the outlook for 2019 is suddenly not looking as good as it did a month ago.

The US has very recently warned Turkey about its intervention in Syria against the Washington-backed Kurdish militia, and possible devastative consequences of such an action. The lira has been further weakening since the beginning of the year on market concerns over falling inflation which could prompt the Turkish central bank to cut its interest rates while the outlook for the currency has suffered a further setback from the latest production data showing industrial production falling for a third straight month y-o-y in November.

Lastly, the upcoming local elections in March cast further shadows over the continued recovery in the lira.

> " Turkish lira had lost almost half of its value between August 2017 and August 2018

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