

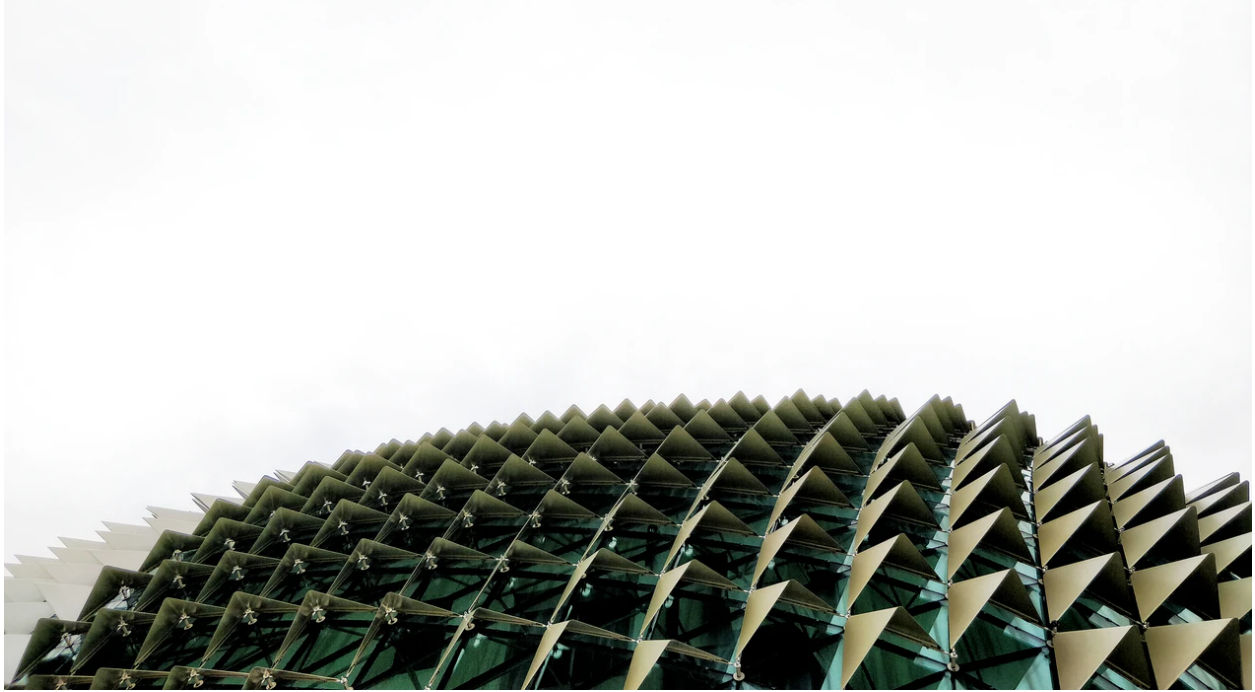


# ***Food Insecurity and Prices***

Canary in the Coal Mine

12<sup>th</sup> February 2021

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## **The Year of Risk and Uncertainty**

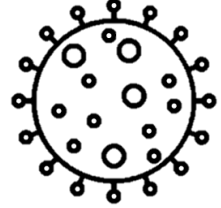
The past year has been a challenge for everyone. A collection of global events has changed the way we interact as a society. This newsletter will explore the impact of *Food insecurity and prices* into 2021-22.

The most destabilising force for an economy is food inflation. It cannot be hidden and it directly affects lower income earners disproportionately. At a time when income inequality is at its greatest and social discourse is at its widest, rising food prices and food shortages have the potential to detonate what is already an explosive environment.

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## The Current Situation and Market Catalysts

2020 started off with Australian bushfires, a financial crisis and the gradual spread of coronavirus across the globe. The stock market correction in March was a testament to the scale of globalisation and the extent of our dependence on international trade. Supply chains have never been more integrated and this year has shown the need for diversification during times of crisis.



As advisors, our job is to analyse these trends and prepare for the future. There are a number of potential scenarios which could impact the macro-level business environment, especially *stagflation* and *food shortages*. Investors should be wary of these trends going forward, particularly when evaluating investment opportunities.



**Stagflation** is often described as the combination of slow economic growth, high unemployment and high rates of inflation<sup>[1]</sup>. Under these conditions, inflation increases and economic output decreases simultaneously, at an extreme level. The global economy has begun to slip, with Australia moving into recession because of the COVID-19 pandemic<sup>[2]</sup>. *Systemic Vulnerability* was created, which has caused scarcity during times of crisis, particularly in the food supply<sup>[3]</sup>.



In recent months, governments have begun taking steps to protect their national food supply. COVID-19 has exposed cracks in the system which could eventually manifest as **food shortages**. Food commodity price data has indicated extremely strong demand, especially for soybeans and milk. Russia is planning to introduce a 30% tariff on soybean exports<sup>[4]</sup>, and this is only one example of governments taking action. Recently, Chinese demand for corn has skyrocketed, helped by unfavourable farming conditions in South America. The price of corn is the highest since 2013<sup>[5]</sup>.



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## Recent Catalysts and Market Reaction

Globally, the food supply is controlled by a combination of industry and government. Around the world, a “perfect storm” has begun to negatively impact agriculture. In Africa and Yemen, new swarms of [desert locusts](#) have decimated crops and livestock<sup>[6]</sup>. Herds are depleted because of increased stress on the farming system. Another factor is the price of soybeans, which have increased by **over 38%** during 2020<sup>[7]</sup>. Soybeans are an essential commodity because they are commonly used as feedstock on farms, this has caused margins to tighten in the agricultural industry.

### US Soybean Futures



Source: *Investing.com*

Governments are beginning to take action. On January 12<sup>th</sup>, the United States Department of Agriculture (USDA) reduced its official estimate of domestic crop harvests within the USA<sup>[8]</sup>. This announcement caused a global spike in the price of corn and soybeans, which has added even more pressure to the agricultural industry. Similar price increases have been experienced in the grain complex in the last nine months.

China's Pig herd was decimated by widespread disease, including outbreaks of swine fever and Porcine Epidemic Diarrhea (PED)<sup>[9]</sup>. "Beijing is under pressure to restore its hog supply and lower meat prices that remain at high levels, pushing up inflation and drawing in record imports". In Vietnam, "The country has reported outbreaks of the highly pathogenic H5N1 and H5N6 bird flu strains in 14 provinces, the government said in a statement on its

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website”<sup>[10]</sup>. These indicators alert us to the fact that food insecurity and food price rises could be a major factor in 2021. Social unrest driven by rising food prices has the ability to negatively impact equity markets.

## **Supply Chain Vulnerability**

The food supply chain can be divided into four sectors: production, processing, distribution and consumption. The importance of food supply chains on global economies cannot be underestimated, and COVID-19 has impacted the entire process from field to consumer. Border restrictions and work from

home orders have allowed demand to oustrip supply, which has caused supermarket shelves to remain empty<sup>[11]</sup>.

### Production

The initial stage of farm production was affected by the pandemic because of labour restrictions<sup>[11]</sup>. Lockdown laws and stay at home orders contributed to this disruption, with most countries still unable to resume operation. Production of fruits and vegetables were heavily affected given the high labour requirement compared to grains and oilseeds. There were also concerns for the availability of pesticides because China is a major supplier. The recent geopolitical tension between China and western countries created a supply risk.

### Processing

The supply chain affects not only producers but also food-processing plants that are extremely labour intensive. Production was restricted by labour shortages due to staff illnesses and lockdowns laws.<sup>[12]</sup> Oxford Academic data shows at least 54,036 US workers in the meat packaging or meat processing industry tested positive for COVID-19, while Brazil saw at least 232 workers in the meat industry lose their lives. Globally, countries like England, Wales, France and Germany experienced similar scenarios with factory related infections and deaths due to the coronavirus.<sup>[12]</sup>

Globally, a shutdown of food production facilities created a ripple effect on the food supply chain. When this was combined with the sudden increase of consumer demand, food and

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commodity prices rose, while any existing inventory was being quickly purchased. In Australia, supermarkets imposed restrictions on the maximum amount of some staples which could be purchased at one time, for example rice, flour and tinned goods. Globally, some restaurants stopped serving meat products. <sup>[12]</sup>

### Distribution

The distribution stage of the food supply chain was decimated by the pandemic. Bulk shipments via ships and barges, which typically contain cereals and oilseeds, saw disruptions because of border closures and increased vessel inspections.<sup>[11]</sup> Similarly, there were disruptions to container and truck transport, which typically carry dairy products. This was also due to delays in border inspections, mandatory quarantines and border closures.<sup>[11]</sup> Furthermore, air cargo, which contains highly perishable products such as berries and seafood, was severely disrupted since its products are transported through passenger flights. Highly perishable product cannot be shipped via barges or containers since they have short shelf lives. The largest decline in global air cargo capacity was between Europe and America, with declines of more than 80%.<sup>[11]</sup> The reduced flights saw huge losses in perishable products with the food supply chain unable to meet the consumer demand.

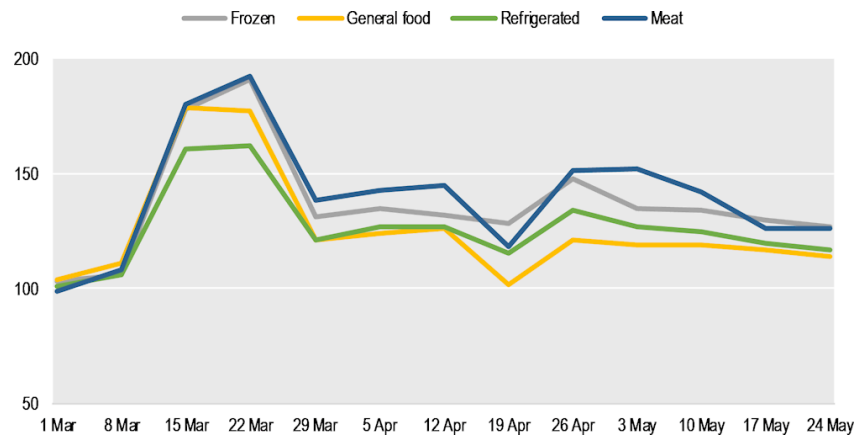
### Consumption

COVID saw major changes in consumer demand, with people choosing to prepare meals at home rather than eat out. Consumers were unable to visit restaurants due to lockdowns, restrictions, and fear of catching the virus. As a result, revenue in the hospitality sector fell drastically.<sup>[11]</sup> Similarly, sales from frozen and packaged products soared due to panic buying and consumers feeling the urge to store food for the long term. Greater consumer demand of kitchen staples resulted in empty shelves, further compounding the issue.

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## Retail Food Demand

Source: OECD



## Victoria's Largest Abattoir, JBS, Shuts down

In July of 2020, the largest abattoir in Victoria was ordered to shut down after four workers tested positive for COVID-19. Pandemic data showed 99 confirmed COVID cases were linked to Somerville Retail Services in Tottenham, 89 to Bertocchi Smallgoods in Thomastown, 76 to JBS in Brooklyn, 50 to Australian Lamb Company in Colac and 10 to Don KR Castlemaines<sup>[13]</sup>. COVID clusters have caused problems in factories that handle meat products, making the food supply chain even weaker.

Victoria's Agriculture Minister, Jaclyn Symes, told ABC News "I'm concerned about the impacts on the industry when we have several cases happening in our meat processing facilities" <sup>[13]</sup>. This quote perfectly demonstrates the increased systemic risk on the food supply chain. Given that JBS is Victoria's largest abattoir, a halt in production and processing caused a local restriction in market supply, sending a ripple effect to supermarkets and the Australian consumer.

In terms of financial stress, Australian companies switched their focus onto people at the cost of profit. Meat processing companies like Midfield Group had to temporarily halt meat processing even though profits were negatively affected. Long-term impacts of the pandemic can be found in company financial reports and growth rates, and the effects will continue in the coming years. Meat processing company, Midfield Group's General Manager, Dean McKenna, stated "It cost a lot, but the decision wasn't made on financials, it was made based on what was best for the people first and foremost".<sup>[13]</sup>

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## Looking Forward

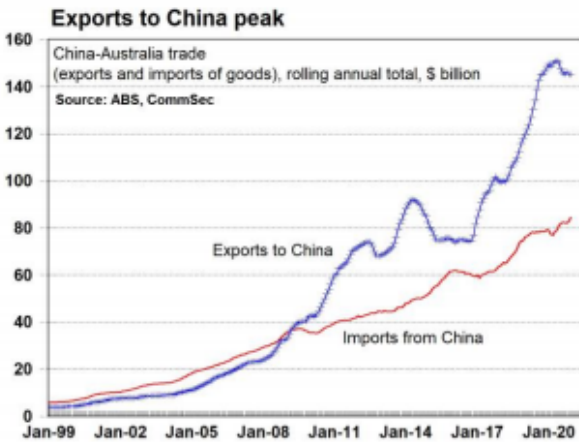
If these trends continue the overall economic impact will be unprecedented. Capital will shift out of highly speculative businesses and into essential manufacturing or production based companies. 2020 was extremely volatile and investors have begun to lose confidence in governments. Smart businesses have begun to de-risk supply chains and stockpile the resources that are necessary for operation. Overall, a reduction in the food supply could significantly impact equity pricing. The forward looking investor will look to diversify and reduce risk where possible, but also capitalise on these trends.

On an individual level, it is possible that the average Australian will be directly affected by stagflation and rising food insecurity. As the commodity supply remains stable and demand increases, the price of staple food sources could increase exponentially (particularly for crops that are grown overseas). We suggest that you monitor developments closely. Remember the Arab Spring started in Tunisia with the price rise in grains in 2012. It then spread through the Middle East and was quite destabilising for the next 2 years.

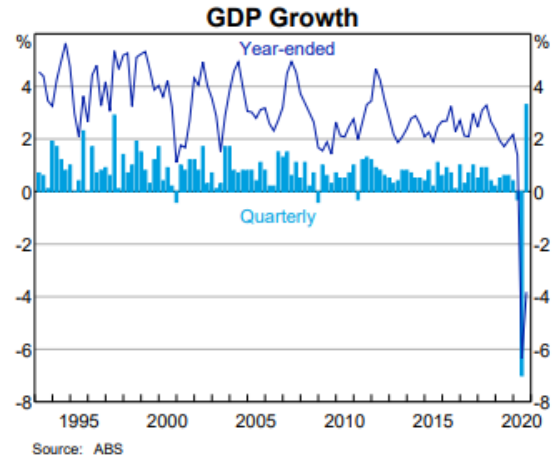
## Economic Outlook and Final Word

The Australian economy experienced significant turmoil in 2020. GDP has recovered from its original shortfall and corporate earnings are steadily increasing. The outlook for 2021 is relatively positive, although highly dependent on the vaccine rollout and commodity stability. Government and fiscal policy will continue to influence the business environment and act as a market catalyst for investors. It is important to remain aware of these macro-level trends and conduct your own research when evaluating investment opportunities. Overall, a reduction in the food supply and a corresponding increase in the price of food could significantly impact equity prices if it translates to social unrest. Australia is well positioned when it comes to food, a small population and large land mass has resulted in excess food. This excess food can become a large revenue earner to shore up Australian balance sheets.

We have attempted to find a stock on the ASX that can protect investors from this risk. Unfortunately the ASX is littered with failed investments in this area and as yet we have not found a recommendation Canary can get behind. The advisors at Canary Capital are available for discussion and can be contacted on [Research@canarycapital.com.au](mailto:Research@canarycapital.com.au)



Source: Commsec Economic Insights



Source: Australian Bureau of Statistics

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