



TOPIC: SUPPLY CHAIN, AGRIBUSINESS

## A SEQUENCE OF IMPERFECT EVENTS

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Agricultural commodity prices have been trending up since the latter half of 2020, driven by significant import demand, reduced global supplies, and tightening stocks in major exporting countries. “I’ve been in the industry for the past 25 years and I’ve never seen anything like this, and probably won’t see anything like this again,” says Brent Atthill, Managing Director of market insights firm RMI Analytics GmbH commenting on current barley and wheat prices. “Everything has gone up in price. It is a major inflationary period for brewers, driven mainly by the grain side of the equation: corn, wheat, and barley.”

For a brewing industry that only just recently began to recover from the effects of the COVID-19 pandemic, spiking grain and malt prices mean that the brewing industry is experiencing one of the most challenging times in its modern history.

### Climate challenges

Last year, a severe drought downgraded corn, wheat, and barley production across the north-western regions of the USA and crucially, Canada, one of the world's leading grain suppliers. The former's barley production decreased from the expected 3.5m tonnes to 2.3m tonnes, while Canada's barley production was nearly half what the US Department of Agriculture (USDA) forecasted, down to 6.5m tonnes from 12.5m tonnes. Canadian wheat production was disappointing too, from the expected 31.5m tonnes down to 22m tonnes.

The defaulting crop in North America led Canada – normally a net exporter of grains – to purchase from Europe and Australia instead, which contributed to global barley and wheat shortage and inflated grain prices as a result. Earlier this year, Bloomberg reported that France's Rouen port was loading its first-ever cargo of barley destined to Canada.

Alongside volumes, the overall lower quality of the 2021 crop posed further challenges to the brewing sector. "In general, one hectoliter of malting barley should weigh well over 65kg, up to 70kg. Last year, some malting barley was down to 60kg," points out Daniel Huvet, France-based, Director of Agribusiness at First Key Consulting, "This is because of the hot weather that we got at the end of June last year, which caused the barley kernels to be of much smaller size than what maltsters would normally expect. When it comes to malting, that means that you need more barley volumes to produce the same amount of malt."

According to H. M. Gauger GmbH's latest reports, the challenges brought by crop failures in 2021 will be having repercussions for the North American region well into next crop year.

## Tariffs and conflicts

Alongside disappointing volumes and quality levels, a number of politically driven challenges converged to send global agricultural commodity prices to near-record levels.

In the early stages of the COVID-19 pandemic, China engaged in a trade battle with Australia that encompassed multiple goods, including beef, lamb, coal, wine, and barley itself.

While leading Australian wine producers can side-step China's prohibitive tariffs by offshoring production – Penfolds maker Treasury Wine Estates is releasing a label made within China itself, while Casella Family Brands recently announced that all Yellow Tail destined to China will be made in Chile – barley traders have no comparable means to circumvent the tariffs. "For geopolitical reasons they instituted a very prohibitive tariff on Australian barley, whose size corresponds to 80.5% of the price of the barley. The tariffs started in 2020 and were implemented with a five-year timeframe, so in theory they will still be with us until 2025. Essentially, they prevented Australian barley from moving to China, although Australia used to be a major supplier. Looking back at it now, we see the impact of this decision," explains Atthill. He highlights that the People's Republic's need to look for barley elsewhere put further pressure on the world grain supplies: "In the backdrop of all that," he adds, "China was very quick to recover from the impact of the pandemic in 2021, so their purchase of grain commodities – corn, barley, and wheat – has been higher than it's ever been in the past seven years." According to USDA data, China's 2020/2021 barley imports were more than double those of the previous year, while volumes of corn imports grew nearly sixfold. Grain was imported from Europe, Argentina, Canada, as well as from Ukraine, before the eastern-European country faced Russia's invasion.

Known as the breadbasket of Europe, Ukraine is one of the world's major sources of feed barley and wheat. When combined with neighbouring Russia's output, it is responsible for about one third of global supplies. While for the most part Ukrainian wheat and barley are not directly employed in the brewing industry, the conflict prompted fears of grain shortages that is, in turn, fuelling further price volatility. "The Ukraine situation has effectively eliminated a third major origin of barley for China and for the world, and has raised the big question, is there going to be barley and wheat still grown in Ukraine? And if so, can it actually get to market? Can you move it from the farmers' fields? Are the rail lines still available? Are the ports damaged? All these questions have just raised uncertainties which have just led to upward price pressure both in barley and wheat," says Atthill.

Ukraine's agriculture ministry recently revealed that the country's May grain exports were considerably lower than expected, with a mere 643,000 tonnes having left Ukraine since the start of the month as opposed to the 1.8 million in the same period last year. Before Russia's invasion, the country managed to export up to 6 million tonnes of grain per month. Recently however, Turkey announced a promising deal with Ukraine, Russia, and the UN aimed at resuming Ukrainian grain exports blocked by Russia, which could potentially a standoff that has been having a dramatic effect on price and availability of grain across the globe.

Alongside Ukraine's reduced exports, the conflict might further impact the grain market in the form of economic sanctions towards the invader. "Russia is also a major producer of barley and wheat," Atthill points out. "But while Russia might have available supplies, some countries might try to avoid buying from them, and that would have a further detrimental effect on prices."

## Costlier pints

In its latest report, Heineken unveiled positive results for the three months to March 2022. As drinkers returned to pubs and bars following the removal of Covid restrictions, its net revenues went up by 24.9% (\$6.1m) while beer volumes increased by 5.2%. Despite such a positive quarter, the group announced its intention to raise prices for consumers, attributing the decision to the inflated barley and wheat prices combined with wider production and supply chain cost hikes, including fuel, aluminium, glass bottles, and cardboard.

"Looking ahead, we see more macroeconomic uncertainty and expect significant additional inflationary headwinds putting further pressure on our cost base," states Heineken chairman Dolf van den Brink. "We will take additional actions including pricing to manage these challenges whilst we continue to invest in superior, balanced growth and sustainable value creation."

Asahi Group Holdings Ltd. also claims that high barley and wheat – as well as packaging and transport – costs led to its decision to raise beer prices. As of next October, retail prices for its Super Dry beer and other beverages will increase 6% to 10%. "In the past crisis (2007-2008) the inflation was about 13%-14% and beer prices went up by the same amount, essentially to rebalance their business," says Atthill. "Now, inflation looks more like 16%-18%. If nothing changes, we are looking at beer prices going up by at least 15% as a response to that. We are recovering from the pandemic, but the concern is that if brewers go down the route of price increases, could that eventually slow down the recovery?"

## Looking ahead

Despite current challenges, brewers are unlikely to be left without grain supplies. Dr. Nigel Davies, Senior Advisor, Technical Services and Sustainability at First Key Consulting, notes that “maltsters are used to adapting their process to whatever the seasonal variation gives them, but there needs to be a corresponding reflection in specification from brewers and distillers to allow the required volumes to be produced if processing times need to be extended to cope with variable barley quality which ultimately restricts the number of batches capable of being processed”.

According to the USDA, the world's barley crop's forecast dropped from last month's 147.26m tonnes down to 145.526m tonnes, yet recent reports show prospects for large crops across a number of key regions, including the USA, and Brazil. Good early yields of winter barley have been reported across southern England, and the country's 2022 wheat production is also expected to increase. There are however concerns over Argentina, where dry weather conditions might affect barley yields, China, and over India's wheat crop. Furthermore, the latest bulletin issued by the European Union's crop monitoring service (MARS) highlighted that the yield forecasts for soft wheat, durum wheat and winter barley across the Union are just below the 5-year average, the main cause being “the continued drier-than-usual conditions in large parts of Europe, with the strongest impacts in regions where these are combined with hot temperatures”.

MARS cut barley's overall projected yield to 4.88 tonnes per hectare (t/ha) from the 4.97t/ha forecasted in April, taking into account drops in the projection of both spring barley (4.31t/ha down to 4.19t/ha) and winter barley yields (5.79t/ha down to 5.73t/ha). Meanwhile, overall wheat yield forecast went from 5.69t/ha projected in May, down to the current 5.56t/ha.

Within this scenario, it might take longer than a single crop cycle for grain prices to ease. “With most cultures you only get one crop a year and you can't accelerate that. This is a two-to-three-year problem to resolve, and we need to have at least two-to-three average crops to achieve this goal. But we just can't afford any further disruption, another drought, or other impacts to supply,” says Atthill. “I wouldn't be too greedy in what I ask for. The best thing this year would be to have a good average crop production in North America, South America, and Europe, and that would move things a little towards a more comfortable position.”

By Dr. Jacopo Mazzeo

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