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**Scotland Food & Drink  
Partnership**

# Food and Drink: Inputs, Inflation, Costs and Commodities

28 July 2022

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## Report Sources:

- AHDB
- Barclays
- Coffey CGA
- DHL
- Drewry WCI
- EY
- FT
- HM Treasury
- ICE Futures
- IGD
- Kantar
- KPMG
- Metro MI
- NAPD
- Nielsen
- ONS
- Refinitiv
- Sea Intelligence
- The Grocer
- The Knowledge Bank
- Trading Economics
- UK Hospitality
- USDA

## GLOBAL / UK OUTLOOK

The conflict in Ukraine has **hugely increased inflationary pressures** across the world, but inflation was already rising in many EMEA markets even before the conflict started. Since then, inflation has increased rapidly across most major economies, and is set to remain high **for the rest of the year**.

Most economists expect inflation to **start falling by the end of the year**, but even in **2023** it's likely to be **significantly higher** than most consumers are used to.

### Stagflation

According to the Bank for International Settlements a mix of high inflation, high and volatile commodity prices and significant geopolitical tensions bears an uncomfortable resemblance to past episodes of **global stagflation**.

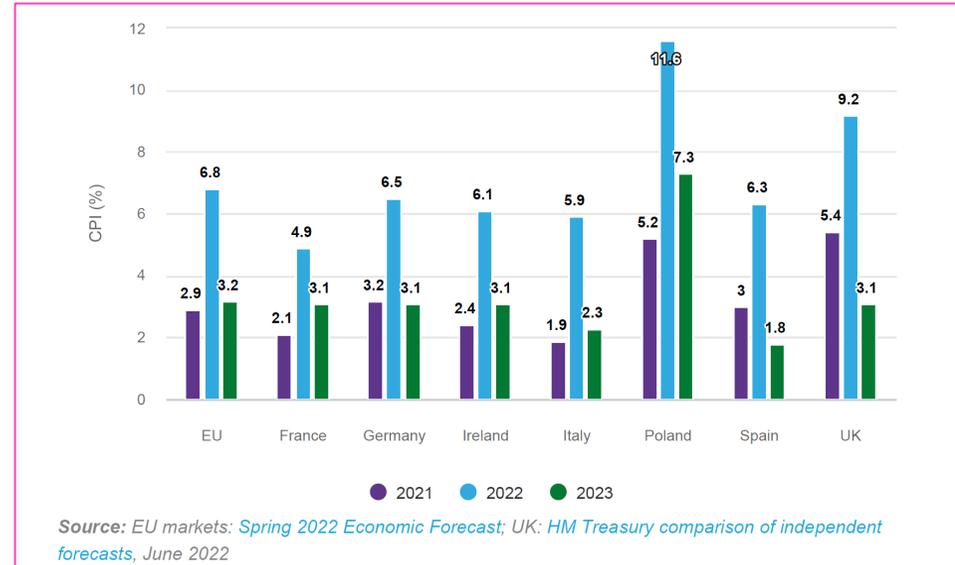
An uncertain growth outlook in China reinforces the downside risks. Unlike in the past, stagflation today would occur alongside **heightened financial vulnerabilities**, including stretched asset prices and high debt levels, which could **magnify any growth slowdown**.

### UK

The annual inflation rate in the UK increased to 9.4% in June of 2022 which is the **highest rate since 1982** and slightly **above market forecasts** of 9.3%. The biggest price pressure came from the cost of motor fuels which increased at a record 42.3%.

**Food prices** made the second biggest upward contribution (9.8%, the **highest rate since March 2009** vs 8.6% in May), namely milk, cheese, eggs, vegetables and meat.

### CPI Across EMEA Markets 2021-23



### UK Inflation July 21-June 2022



Source: ONS

# Inflation Impact



# INFLATION: 2023 and Beyond

## Global

Inflation is being driven by rising costs for energy and materials, worldwide, not by demand in the UK market specifically (ie: inflation is primarily 'supply side', with war being a major factor).

According to Barclays Consumer Staples Research **Key global commodities** such as wheat, corn, soybeans and palm oil are now **down around 25%** from their peak in the aftermath of Russia's invasion of Ukraine.

A rising dollar, plus better harvest predictions in the US, have helped cool surging prices, but the biggest factor is **increased concerns over recession** and the worry that higher interest rates needed to tackle inflation could stoke demand destruction.

The issue is that commodity inflation is not the only inflation manufacturers are dealing with. **Wage inflation** could be an even bigger issue next year, plus **ESG** and sustainability costs continue to go only in one direction. However, these costs are notoriously much harder to pass on.

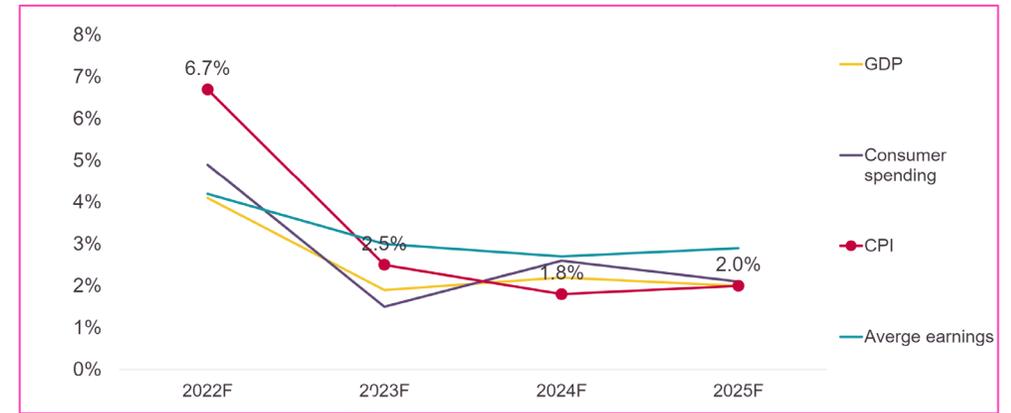
## Scenarios

Procurement personnel have rarely been under so much pressure to make the right calls on pricing and hedging. The big question is: what does **2023** look like and how much pricing will manufacturers be able to hang onto if commodity prices continue to roll?

The **optimistic scenario** is that pricing will remain much stickier in revenue growth next year relative to inflation rolling over, which will result in a bounce in margins.

The more **cautious scenario** is that a slowing economy drives significant trading down and private label gains, which impacts both volumes and sales mix, and the pricing benefit from lower commodities is passed back to the retailers in relatively short order, negating much of the margin relief.

EY Item Club Economic Forecast June 2022



Source: EY Item Club June 2022

## IMPACT: Retail

### Retail

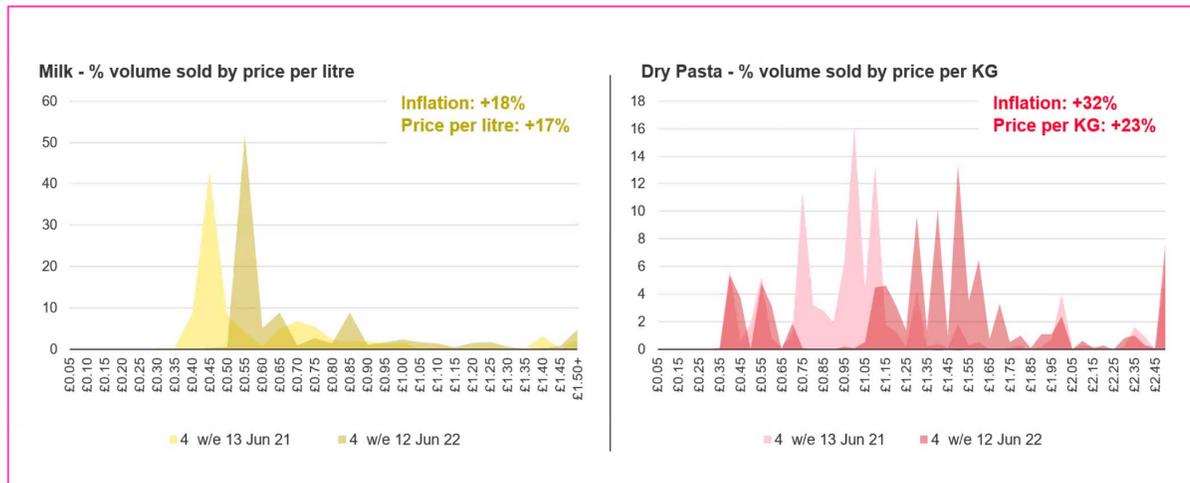
**Inflation** has replaced the climate emergency as **the most important issue** facing Britain today, according to a public survey by Ipsos Mori. The rising cost of living is now one of the biggest concerns for 40% of Brits, **the highest level for around 40 years**. The Ipsos Mori survey found **petrol prices** was also among the top concerns, with 11% of people now mentioning it as an issue of concern.

Certain demographics appear to be more worried about the inflation than others, with 45% of those between the ages of **35 and 54 concerned**. Those aged 18 to 34 are the least concerned group, but 35% mentioned inflation as one of their concerns.

### Shopper Behaviour

According to research by Kantar, the year on year **volume declines** in retail are still **mainly a result of post-lockdown comparisons**, not inflation. In fact shopping behaviour is unlikely to change drastically, even as prices increase. Data tell us that grocery shoppers are prepared to absorb around 75% of price increases. But the impact of price rises varies by economic group, demographic, category and tier.

#### Shopper Price Rise Absorption June 22



The examples on the left (Kantar FMCG Panel) show that inflation in milk is running at **+18%** and the price that shoppers are prepared to pay is **+17%**.

For dry pasta, however, shoppers don't want to absorb the **32%** price hike, are trading down to lower tiers, but on average are still paying **23%** more.

Knowing what the category norms are when setting prices has always been important but even more so in an extended and **volatile** period of price rises.

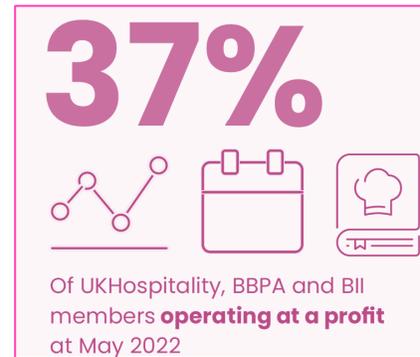
Source: Kantar FMCG Panel 4 w/e 12 Jun 22

## IMPACT: Foodservice

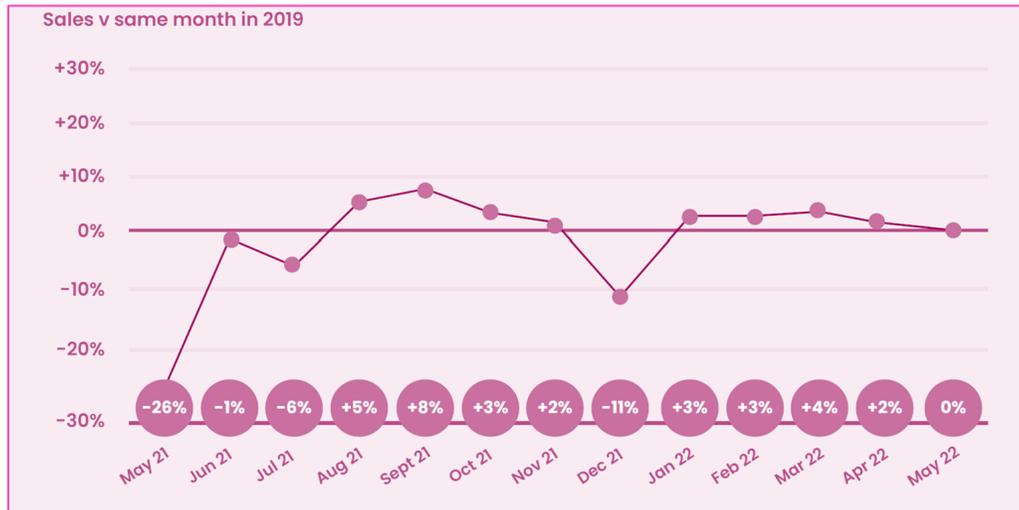
With the costs of both supply and labour increasing well ahead of the general rate of inflation, it is clear that hospitality has been **disproportionately hit** by the costs crisis of 2022. It has forced businesses into some difficult decisions, not least about how much of the inflation can be absorbed, and how much needs to be relayed to consumers.

At the start of 2022, nearly all (95%) said they had passed, or were planning to pass, at least some of the extra costs on to guests in the form of **menu prices**, at an **average increase of 8%**. Both numbers will inevitably have increased over the Spring.

A recent survey of members of UKHospitality, the British Beer and Pub Association and the British Institute of Innkeeping shows how rapidly rising costs, supply chain issues and labour shortages have sapped hospitality's cautious confidence. Most concerning is the finding that **fewer than two in five (37%)** businesses were **operating at a profit** in May 2022.



### Managed Groups' Sales May 21 - June 22



Source: Coffer CGA

The Coffer CGA Business Tracker has shown how managed hospitality groups' **sales** were **just ahead of the levels of 2019** in the first four months of this year. But with inflation at such high levels, they have been **well below the pre-COVID markers** in real terms.

With Consumer Price Index inflation hitting 9.1% in May—the **highest point for more than 40 years**—it is extremely difficult for any hospitality business to achieve real-terms year-on-year growth at the moment.

# Commodities



# FISH / SEAFOOD

## Whitefish

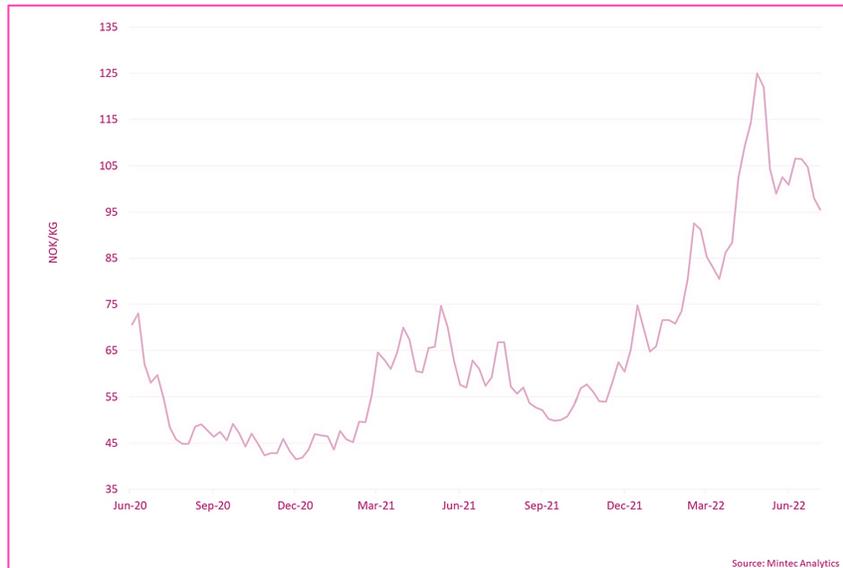
The delayed UK 35% tariff on whitefish from Russia and Belarus could lead to **different species in shops and higher prices**, industry leaders have warned. Russia controls 45% of the global whitefish supply so removing this fish from the seafood supply chain will have impacts as businesses try to find alternative sources of supply.

The tariff came into force on 19 July and will affect seafood imports of Russian origin. However, crucially, **Russian-caught product that is processed in another country will not be included**. Additionally, any consignments that have already cleared Russian or Belarusian customs and are en-route to the UK will be unaffected.



Source: FT / Mintec

## Norwegian Salmon 3-6kg Spot Price



Source: Mintec Analytics

## Norwegian Salmon

Since peaking at an **all-time high** of NOK 125.0/kg in late-April 2022, the Norwegian farmed salmon price (3-6kg, fish pool index) **fell** by NOK 29.4/kg (-23.5%) during the ensuing 10-week period to NOK 95.6/kg.

Robust farming activities and a strong harvest contributed towards the **downward momentum**. Additionally, Chilean salmon exporters, buoyed by plentiful supply, are increasingly targeting buyers outside of their traditional markets in North America. This is **intensifying the price competition** for market share in Europe.

Meanwhile, the COVID-19 related lockdowns in China also implies a higher proportion of Norwegian salmon being redirected to Europe, further increasing the regional surplus.

# CEREALS

## Wheat

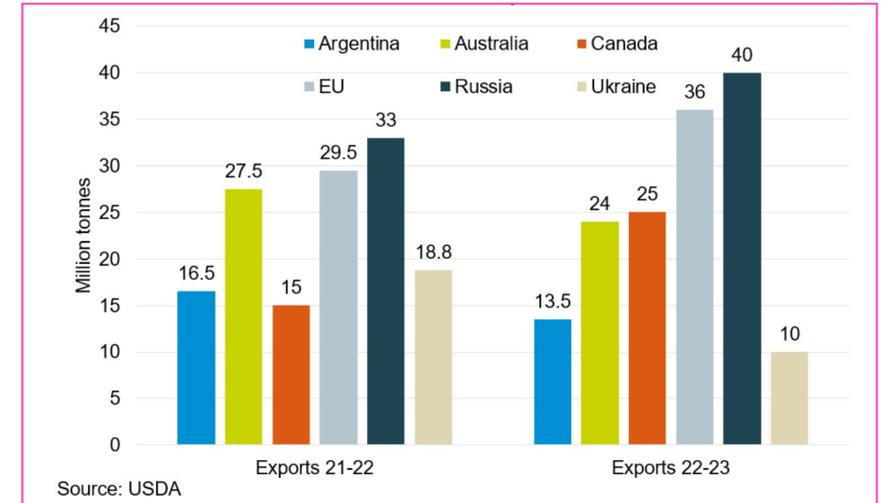
With supply deficits of wheat in parts of the world for 2022/23, it is expected that there will be stronger global demand for European new crop. This demand could offer support to Paris milling wheat futures, which inherently could **filter into UK domestic prices**.

Over August 2022 quantifying grain yields from the EU & Black Sea harvests will be key in setting some market sentiment for the 2022/23 marketing year.

With high EU demand to some extent factored into the market, even further demand could help maintain these **historically high prices**.

EU wheat exports are expected to reach their second-highest level on record, at 35.5Mt in 2022-23, up by 6Mt on last year.

USDA Wheat Export Estimates 2022-23



USDA Wheat Export Estimates 2022-23

Futures market	UK feed wheat	Paris milling wheat	Chicago wheat	Chicago maize
Contract month	Nov-22	Dec-22	Dec-22	Dec-22
Price (per tonne)	£257.90	€316.75	\$291.72	\$237.70
Change on week	-\$27.10	-\$28.25	-\$41.33	-\$7.77

18/07/2022

Source: AHDB

## Markets

Global wheat markets continued to **slide sharply** across the start of July. Dec-22 Chicago futures ended the week at \$291.72/t, **down** by \$41.33/t Friday-Friday, to reach their **lowest level** since mid-February. The downturn was led by rising optimism that Ukrainian grains shipments could soon return to the global supply chain, following advanced UN-brokered talks to end the blockade at the start of July.

However a day after Moscow signed a deal **allowing Kyiv to resume grain exports** it claimed responsibility for a series of **missile strikes** that hit the key Ukrainian port of Odesa

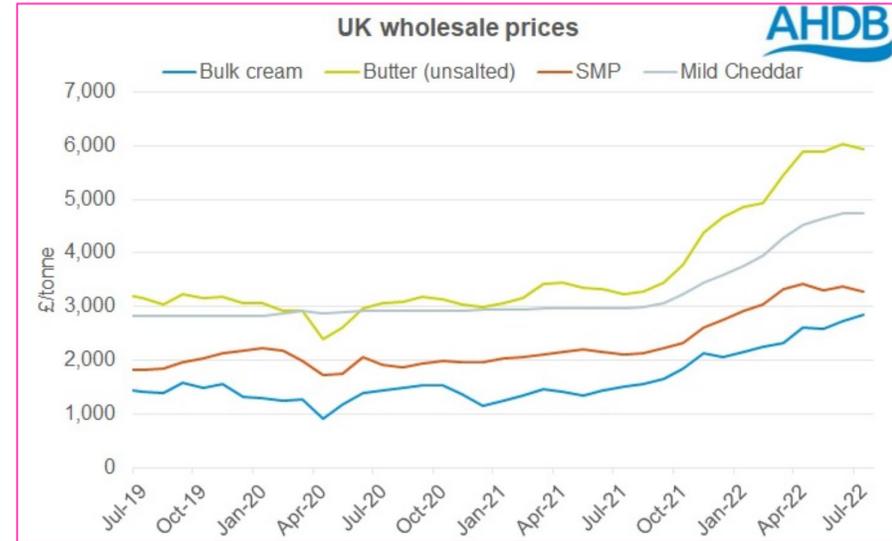
## DAIRY

UK dairy wholesale markets saw some **weakness** this month, with butter and SMP prices down on the previous month. This is not unusual for July, as the summer holiday season means there is little interest in buying. However, alongside this there are signs of **reduced demand in response to high prices**. Negative movements on international markets is said to be adding nervousness.

The downward move in prices has led to buyers holding off awaiting further falls. Overall, this has put **downwards pressure on prices**, and it will be a couple of months before we know if this was due to the short-term holiday lull or to lower demand.

**Butter** prices weakened through the month. The market was very quiet, with most traders on holiday, particularly in Europe. With little activity, the price drifted downwards. There was some additional buyer nervousness around reduced demand, so those not on holiday were thought to be **waiting on further price declines**.

**Mild Cheddar** markets were equally quiet, but more stable as very little spot trade occurred. Price reports were a mix of steady pricing and of a **marginal £50/t drift downwards**.



### UK wholesale prices

£/tonne	Jul-22		Jun-22		Jul-21	
	Average	Range	Average	% change	Average	% change
Bulk cream	2,850	n.a.	2,734	4%	1,508	89%
Butter	5,940	310	6,020	-1%	3,230	84%
SMP	3,290	550	3,380	-3%	2,110	56%
Mild Cheddar	4,740	200	4,740	0%	2,980	59%

Source: AHDB

### Dairy Index Global July 2022



Source: Mintec

# SUGAR

## Brazil

Sugar futures on ICE extended their plunge to 17.6 cents per pound in late July, the lowest in one year, as investors continued to assess the **strong outlook of sugar supply**. Brazilian state-owned oil giant Petrobras announced it will lower gasoline prices by 5%. The consequent downturn in ethanol prices will make biofuel blending less profitable, swinging the allocation of **sugarcane for producers to crush sugar instead**.

On top of that, a weaker Brazilian real added to the bearish outlook. Still, the flight from ethanol distilling is expected to be capped after two of Brazil's most populous states, Sao Paulo and Minas Gerais, cut taxes on sugar ethanol.

Data from industry leader Unica pointed to 45.3% of cane crushing being used for sugar in the second half of June, down from 47.6% a year ago as producers **took advantage of volatile energy prices**. The change explained a 15% drop in sugar output during the period.

## EU

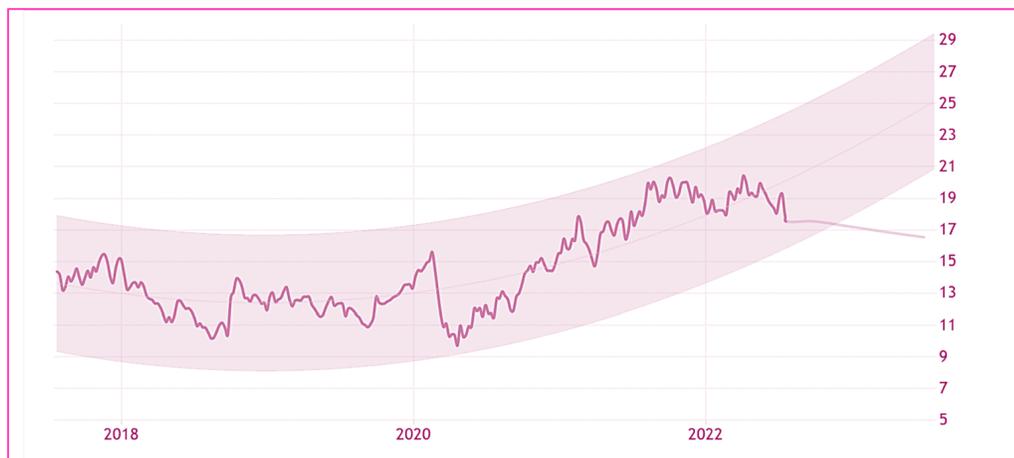
The European Commission estimates that **EU27 sugar production will decrease by 5% in 2022/23** owing to the recent dry and hot weather.

However, due to the increase in production last year 2021/22, EU ending stocks of sugar are expected to recover to 1.9 million tonnes, **more than 50% higher** than the very low ending stocks last year of 1.2 million tonnes.

## Forecast

Sugar is expected to trade at 17.54 Cents/LB by the end of this quarter, according to Trading Economics global macro models and analysts expectations. Looking forward, they estimate it to trade at 16.54 in 12 months time.

Sugar Forecast Prices (cents / lb) 2022-23



Source: Trading Economics

# Energy



# ENERGY

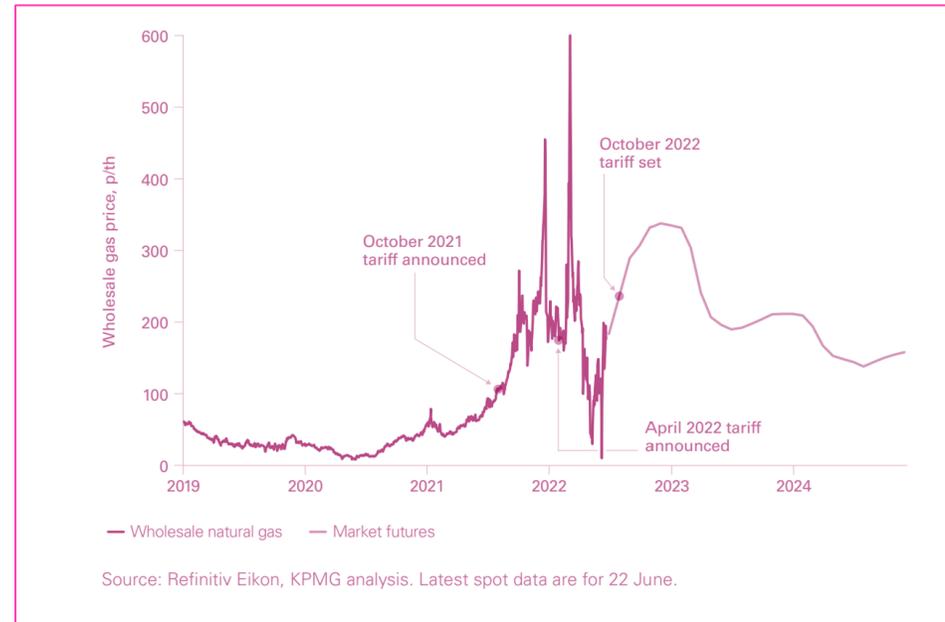
## Natural gas

Because of regulated energy prices being revised in October (see Chart), analysts expect the full impact on UK inflation to only materialise in the autumn, with the outlook for inflation remaining highly dependent on the evolution of future wholesale gas prices. Latest media reports suggest that Ofgem's next revision could see the utility tariff cap increased to around **£2,800, 42% higher** than its current level.

UK natural gas futures were trading around the 300-pence-a-them mark, closing in on its **highest in more than five months**, underpinned by uncertainty over Russian supplies and **elevated demand from the EU**. Volumes at The Nord Stream pipeline stood at 40% of capacity, the same as before the maintenance works but still well below levels this year.

Russia's President Putin warned that flows through the pipeline could be slashed to just 20% of capacity later this month unless a spat over sanctioned parts is resolved. Still, the channels linking Britain to the EU have been **working at full capacity**. The **UK** has been using its **excess regasification capacity** to import more LNG and resell it as natural gas to Europe.

## Wholesale Gas Prices / Futures



## Crude Oil

West Texas Intermediate (WTI) crude futures fell **below \$94** per barrel w/c 25 /07, sliding for the fourth straight session, as fears that a global economic slowdown would hurt energy demand outweighed signs of **ongoing market tightness** and disrupted supply. President Biden **failed to secure a pledge** from Arab leaders **to pump more oil**, while Russia's Central Bank Governor said that Russia will not supply oil to countries that would impose a price cap on its oil.

Crude oil is expected to trade at **98.36 USD/BBL** by the **end of this quarter**, according to Trading Economics global macro models and analysts expectations. Looking forward, they estimate it will trade at **110.19 in 12 months time**.

# Packaging



# PACKAGING

## Resins

UV resins, polyurethane resins, solvents, glycols, acrylic resins, and other petrochemical raw materials and derivatives have recently seen **major price increases**.

The volatility of most resins has been exacerbated by a rise in crude oil prices, as well as the current uncertainty surrounding the sanctions imposed on Russia as a result of the Ukraine conflict

**Polyester resins** are facing **similar troubles**, with facility closures in Singapore and Sweden, as well as an explosion at a factory in China, worsening the situation. As a result, suppliers divert commodities to their own markets, **driving up costs even higher**.

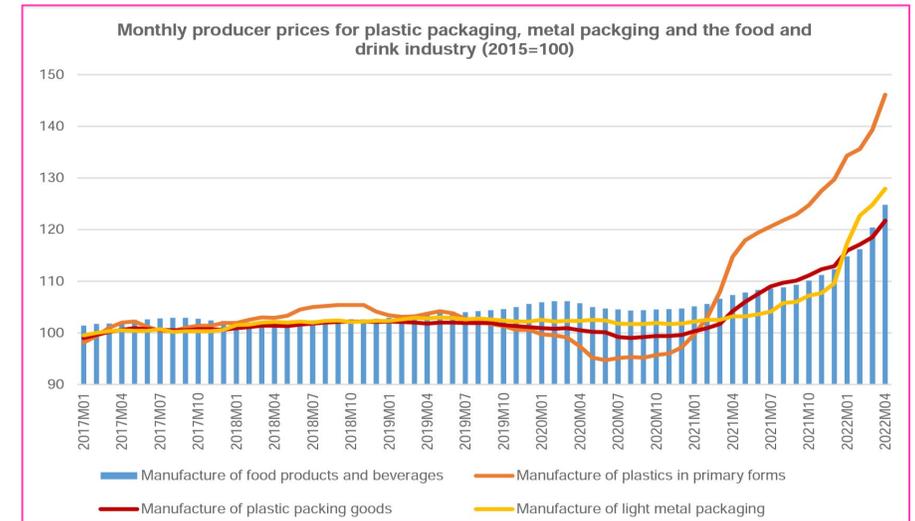
## Glass

The CEO of British Glass has **no concern** over the **bottle supply in the UK**. “It is the case that there is a high demand for bottles across Europe, which could lead to a knock-on effect, but it doesn’t appear that there will be a shortage of bottles produced in the UK based on current demand.”

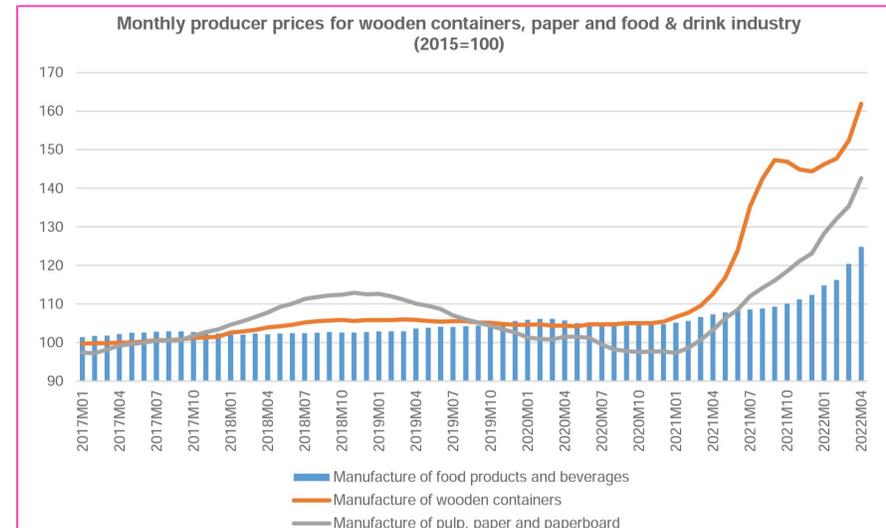
## Pallets

The used wooden pallet industry is reporting a **large uplift in enquiries** from supply chain users, as the prices of inputs including raw materials and transport have increased.

According to members of the National Association of Pallet Distributors (NAPD), **demand has risen to “unparalleled levels”** – up to **70% higher** and from further afield than usual – as businesses seek to reduce costs of manufacturing, packaging, and delivery of goods.



Source: Eurostat (STS)



Source: Eurostat (STS)

# Fuel / Freight



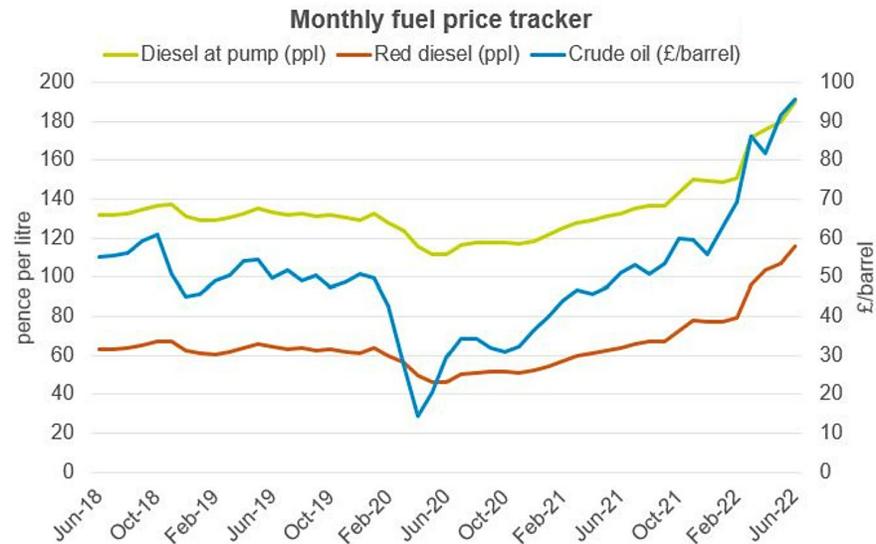
## FUEL / ROAD FREIGHT

### Europe

European road freight rates hit **an all-time high** in Q1 2022 as rising cost pressures, supply and capacity disruptions, regulatory change and war in Ukraine created a **potent mix of rate drivers**.

A **surge in demand for road freight** services has further exacerbated price increases and the increases in the cost base are set to continue into 2022, **stating a possible increase of 35%** compared to the levels in mid-2020.

The **shortage of international drivers** continues to act as a drag on sector performance, diminishing available capacity, though recent UK figures suggest that the **driver shortage is lessening**, with 27,144 HGV vocational tests undertaken in Q4 2021, a **53.5% increase** compared with Q4 2019.



Source: HMRC, Defra, DECC, OPEC

Month	OPEC price (US\$ / barrel)	OPEC price (£ / barrel)	UK red diesel (ppl)*	UK diesel pump price
Jun-22	117.72	95.54	115.69	190.15
May-22	113.87	91.46	106.88	179.58
Month-on-month change	3.85	4.08	8.81	10.57
% change	3.4%	4.5%	8.2%	5.9%
Jun-21	71.89	51.24	63.95	132.91
Year-on-year change	45.83	44.30	51.74	57.24
% change	63.8%	86.4%	80.9%	43.1%

Source: Defra, DECC, OPEC, ECB

Pricing in the European road freight market continues to rise, in response to falling capacity, rising demand, and increases in the cost base, especially in **diesel prices**, which now account for 50% of truck operating costs.

For the first time in several years, **seasonal congestion** will be a problem as tourists flock to motorways in the summer months, creating congestion and costing carriers time and money.

## SEA CARGO

### Scotland / China

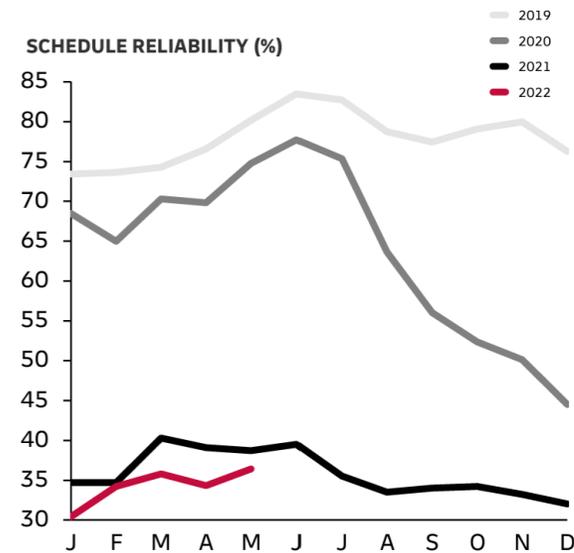
The **first direct container service** connecting **China** and **Scotland** is being launched in response to growing global pressures on the supply chain.

The new east and west bound freight route from Chinese ports to **Greenock Ocean Terminal** is a partnership between KC Liner Agencies, DKT Allseas and China Xpress.

The move will provide Scottish importers and exporters with a **direct port of call** and eliminate decades of frustrating issues with trans-shipments and delays at other European ports.

The direct sailings should almost **halve the transit times**, compared to feeder services via continental Europe or other southern UK ports.

### Ocean Container Schedule Reliability



Source: Sea Intelligence, DHL

Schedule reliability has **improved** again to 36.4% in May to the highest reading so far this year. Despite this improvement the May 2022 figures is still 2.3 ptp lower than the year before.

The **lowest reliability** was again recorded on the Asia-Oceania trade (18.3%) while the Oceania-North America trade was the best performing trade (64.4%).

Drewry World Container Index - 21 July 22 (US\$/40ft)



Ocean rates have **fallen significantly** in the last few months, but at more than \$9,500 per container from China to the US, **prices are still about 6.5 times higher than in June 2019**.

Importers have accepted the additional expense as the cost of keeping shelves stocked and have also come to expect significant delays. This means adjusting ordering patterns to meet customer demand.

The **port congestion** in **Europe** is still a major issue which delays schedules; more blank sailings have been announced by all carriers and alliances.

# Labour



## LABOUR

### Tightening

The UK labour market has continued to tighten. The unemployment rate was 3.8% in the three months to April, down 4.9% a year earlier. The **redundancy** rate fell to its **lowest level on record**, suggesting that a sharp rise in unemployment appears unlikely in the short term. The main challenge remains the ability of firms to hire workers.

The demand for staff has been growing since the gradual lifting of COVID-19 restrictions last year, but the availability of workers hasn't kept up pace with the job openings. Recent data show that job vacancies continue to match the number of unemployed people, with the **vacancy rate at its record high of 4.3%**

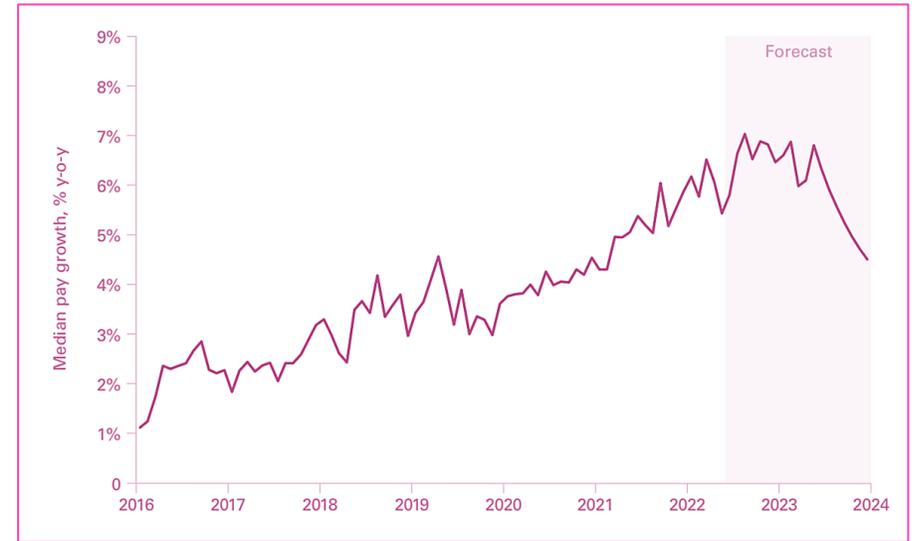
### Pay

KPMG's forecast is for median pay growth to **peak at around 7%**, averaging 6.3% in **2022** and **5.8% in 2023** (see Chart). There is significant uncertainty around this outlook, however. For example, a sharper slowdown in activity could depress hiring more significantly, thus limiting the strong bargaining power currently exerted by employees. Set against that, a **continued inflationary environment** could lead to **escalating pay demands**.

### Out of Home

A recent survey of members by UKHospitality, the British Beer and Pub Association and the British Institute of Innkeeping show how shortages continue to hurt the sector. It identified an **alarming** headline **vacancy rate of 15%** — which means more than **one in seven roles** are now **unfilled**.

### KPMG Median Pay Growth Forecasts



Source: ONS, KPMG

**16%** **Estimated revenue** lost as a result of staff shortages (UKHospitality, BBPA and BII member survey)

# THE KNOWLEDGE BANK

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