FCC Ag Economics

2018 Outlook for the Canadian food processing sector

January 2018

Farm Credit Canada
Advancing the business of agriculture

Canada

FCC Ag Economics helps you make sense of the top economic trends likely to affect your operation in 2018. In this outlook for the Canadian food processing sector, we look at:

- Food prices and competition among food retailers
- Energy markets
- Interest rates and the loonie
- Opportunities in export markets

The 2018 outlook for Canadian food manufacturing is expected to be positive, building on a very strong year in 2017.

Mergers and acquisitions in the food retail sector resulted in price pressures for food manufacturers resulting in a 1.0% decline of food in grocery stores compared to 2016. But while those pressures hit the manufacturing sector, food manufacturing GDP (gross domestic product) in Canada grew 5.0% in 2017.

Food-processing revenues should also grow in 2018. Prices for raw commodities used in the bakery and meat-processing sectors aren't expected to climb significantly. That's a plus, as consumers will access different kinds of food outlets which, coupled with intense retail competition, will help to drive both lower prices and higher demand.

Improvements in Canada's labour market, which will increase labour costs, will also increase domestic food demand, especially as Canadians continue to experiment with new ingredients.

Globally, Canada's implementation of Comprehensive Economic Trade Agreement (CETA) with Europe, and the expanding global middle-class bode well for Canadian agri-food export opportunities in 2018. We don't know yet if NAFTA renegotiations will temper the benefits of an expanding U.S. economy.

How will this affect your bottom line?

With a 2018 economic environment able to support investment in the food manufacturing sector, the time may be right to ensure your investment strategy will carry you through the next business cycle.

You'll likely face higher interest rates, so is this the year to invest in automation? It may be, if you're unable to find enough skilled workers. Emerging online channels and price pressures will also disrupt traditional food supply chains. New horizontal and vertical alliances may be necessary to fight off margin pressures in food processing.

Trends to watch in 2018

Competition among food retailers will pressure food prices

More consumers will buy food online in 2018. Amazon's recent purchase of Whole Foods, Sobey's announced investment in the online shopping experience, and Loblaws' commitment to home delivery are evidence of this trend. It will likely mean continued pricing competition within the food manufacturing sector, and limited ability to pass any additional costs to consumers. We expect food inflation in 2018, but it should be lower than the overall rate of inflation and income growth.

Energy markets have adjusted to greater supply

Global economic growth, combined with steady fuel efficiency gains in developed countries, are expected to keep oil demand healthy. The West Texas Intermediate (WTI) oil benchmark is currently forecast to trade around US$55/barrel in 2018, with some volatility around this range. Oil production commitments of Russia and OPEC (Organization of the Petroleum Exporting Countries) as well as U.S. drilling activity may change this forecast.

Stability in the oil market will bring further stability to heating, cooling, and transportation costs in the food manufacturing sector.

Interest rates to remain low while loonie to stay under US$0.80

The Bank of Canada projects economic growth in Canada to be slightly weaker in 2018 relative to 2017. They also expect inflation will trend around 2.0%, the Bank's mid-point target. Financial markets suggest there will be two or three hikes of 25 basis points in the overnight rate for 2018.

Businesses should take note: although interest rate increases will likely be muted, borrowing costs are projected to climb off historical lows reached in 2016 and 2017. Financial markets currently expect bond yields to climb moderately. For example, a 5-year, fixed-rate mortgage would be priced at the end of 2018 around 75 basis points higher than it was at the end of 2017.

The Canadian dollar is expected to average US$0.78 for 2018 – a competitive advantage for Canadian food processors in the domestic market. In 2017, Canada imported CA$23.0 billion worth of agri-food products. Of that, CA$17.0 billion was from the U.S.

A US$0.78 loonie will also support food exports to the U.S. In 2017, Canada exported $34 billion worth of agri-food products. That represents a year-over-year increase of 5.0% in total agri-food exports. Typically, over 70.0% of Canada's agri-food exports are to the U.S., thanks to favourable exchange rates.

Looking beyond Canada's traditional export markets

The U.S., home to the wealthiest consumer base in the world, is Canada's closest, and largest, food export market. Diversifying beyond that into new global markets and with new foods will depend on Canada's comparative advantage, the size of the global market and pace of growth in global food demand.

Processed foods that are currently a "sweet spot" for Canadian exporters include canola oil, beef, pork, chocolate and bread (among others). "Food preparations," a category currently growing in world markets, also holds potential. CETA, and China and India's expanding middle class will drive these opportunities.

On the radar

- The outcome of the renegotiations of the North American Free Trade Agreement (NAFTA) will have possible implications for:
  - the value of the Canadian dollar
  - trade taxes and market access rules applied to Canadian exports and imports
  - dispute settlement procedures

  Changes in any of these could impact prices of ag commodities in Canada.
- Impact of rising wages on competitiveness of food processors.

Curious about the 2018 outlooks for other sectors? Get them all for a limited time through your Relationship Manager. And for even more insights, read our Ag Economics posts and join the conversation on Twitter using #AgEconomics.

Available outlooks for 2018:

- Cattle
- Hogs
- Farm inputs
- Crops East
- Crops West
- Dairy

41079 E 20180115 RH