

2nd Quarter
2017



SUMMER INFLATION REPORT

Prices Still Rising Modestly – For the Moment!

What has actually kept the economy growing is buoyant household spending. With wages finally rising above inflation, real disposable incomes recovered after years in the doldrums following the financial crisis.

Encouraged by high employment level, record low interest rates and high-street price wars that have kept prices to historically low levels (we even had a spell of deflation for a few months), consumers increased their borrowings to record levels and wow, we're spending. Not only on food, but also heavily on services, having increasingly indulged in the art of coffee drinking, cinema going and eating out. However, some think the party is about to be rudely interrupted. Inflation is gradually creeping up. In fact, Food Away From Home has risen to just above 2.3% in June this year. For the moment, those cost increases are not being fully passed on, but this is beginning to happen and the process is likely to accelerate in coming months. For years, the consumer has enjoyed low prices as stores and savvy

purchasers contained any price increases because of intense competition but this is becoming difficult to sustain.

We have seen a rise in global food prices of 17% over the last year, according to UN data. This is still a lot less than the underlying 2.3% cost changes would suggest and much more food price inflation is expected. There have already been massive increases in individual items including burger, bacon and beef cuts. The consumer has little choice but to pay these. The result is that with inflation rising and real disposable incomes beginning to be squeezed, total spending will be diverted to essentials. So do we need to worry about inflation? Yes. Do we need to worry about the acceleration of food inflation? Most certainly.

Food Inflation Update

The food index rose 0.1% in May, its fifth consecutive monthly increase. The index for food at home advanced 0.1% in May, with the major grocery store food group indexes mixed. Over the past year, the food at home index fell 0.2%, due in large part to the impact of a 2.1% decline in the index for meats, poultry, fish, and eggs. The index for food away from home advanced 0.2% in May, and rose 2.3% over the last 12 months.

Supermarket prices are expected to rise between **0% and 1%** in 2017.

Retail chicken price inflation remains relatively low due to an increase in broilers.

Egg prices are expected to decrease an additional **4% and 5%** in 2017.

Beef and veal prices are expected to decrease **2.5% to 1.5%** in 2017.

Increase in supply of pork is expected to drive prices down by **1% to 2%** in 2017.

As the market recovered from Avian Flu, egg prices fell **21.1%** in 2016.



Beef

Choice Beef Prices are Peaking

After peaking in early May, fed cattle prices dropped sharply into the second half of the month, but then rebounded into early June on tight front end supplies. Cattle prices are now breaking lower and expected to continue falling into mid/late summer lows. March and April feedlot placements were both up by 11% percent over last year, and May placements were likely larger by a similar proportion. Fed cattle supplies will be increasing counter-seasonally from June into July and August. Choice cutout values are likely peaking in the early part of June, and at the highest levels in two years.



Pork

Hog Pricing To Come Down

June and July are the peak times that hogs are needed, and it is also the time when animal supplies are their tight test, putting pressure on prices. This year, animal supply levels are larger than the industry has ever processed; however, animal pricing has not fallen below last year's pricing by any measure. Hog pricing is not expected to continue in the recent upward movement of the past two months, but trend back down on a seasonal basis after July.



Poultry

Chicken Wing Prices Remain High

Following the culmination of March Madness, wing buyers are typically granted a lull in the market as consumers favor outdoor grilling parties to indoor game viewing activities. This year, however, the consumption of wings has firmed up, and have maintained a countercyclical pace through April, May and much of June. May 2017 wing values averaged 197 cents per pound, 20 percent higher than the average of values reported during the same month a year earlier, and setting a new high for the month of May. The latest USDA report indicated that wing inventories at the end of April totaled just 62 million pounds, a number 20 percent lower than April 2016.

Turkey Prices the Lowest They've Been in Several Years

During May, turkey averaged 99.4 cents per pound, the lowest averaged market value during the month of May since 2013, and 14 percent below average reported market values during May 2016. This compares with an average market value of 100.4 cents per pound throughout the first quarter of 2017. The outlook for whole frozen hens and toms is expected to remain just under a dollar per pound through the end of June, then adding 3-5 cents in July, and another 3-5 cents in August.



Dairy

Milk Prices Have Remained Flat, But Are On The Rise

Fluid milk prices were flat in June but should rise substantially in July with higher cheese and buyer prices factoring into the pricing formulas. Fluid milk prices probably put in their low for the year in May and continue to run well above year ago levels. Prices should continue to hold above last year for the balance of 2017.

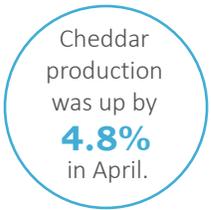
Low Production and Inventory Create Higher Butter Prices

The buyer market is up substantially from May and is showing little sign of turning lower any time soon. Domestic buyer production is down from last year, while commercial inventories dropped below last year. The most noteworthy development is surging international buyer prices. The market may turn down later in the year when the new Oceania milk production season ramps up and suppliers are comfortable with their situation through the year-end holidays.

Following Two Months of Low Prices, Cheese Climbed in May

The CME block cheese price rallied up into the \$1.70s in late May with the support of rising international cheese prices following two months of relatively low prices in March and April. Cheddar production was up a strong 4.8% in April compared to last year, and American type cheese stocks were up 13.7% from last year. The CME block cheese price retreated down into the mid-\$1.60s early in June, which should continue to hold until later in the summer.

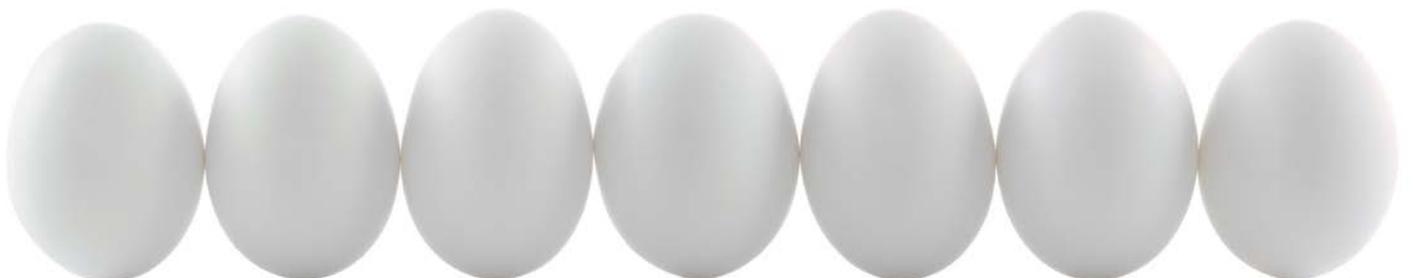
Block cheese pricing, although up in the earlier part of the year, is expected to decline heading into the second half of 2017.



Eggs

Egg Prices Have Remained Steady, With A Slight Lift In May

The number of egg-type hatching layers ballooned last year to a massive 3.9 million before beginning the slow decline to more historically-reasonable levels. The resulting rise in table egg layers may have pushed head counts to the highest point in history during last December. Midwest table eggs were as low as 58 cents a dozen at the end of April, then turned stable and worked higher through May at an average of 65 cents per dozen according to the USDA. Look for shell egg values to hold steady in the near term.





Biofuel

Diesel Fuel Prices The Lowest Since December

Retail diesel prices averaged \$2.56 in May, and are expected to be around \$2.54 in June. If realized, the price is the lowest price since December. The recent modest decline in crude oil prices, which make up about 45% of the price of retail diesel, is the main driver for diesel prices. Despite an improving US economy, diesel prices should remain rather tame, with global dynamics dictating price direction more than outright economic activity.



Wheat

Wheat Markets Sensitive to Weather

The US wheat markets have been trading reflective of weather recently. Dry conditions across the US Northern Plains have helped wheat markets trade to their highest value in about two years, with closes above \$6 per bushel registered in June. If the weather breaks, the market likely will soften, but conditions would need to drastically improve to drive prices notably lower. Winter wheat harvest is underway for the US with early reports pointing to another year of below-average protein levels for the HRW crop. Although harvest is far from complete, if this year's protein levels are low, high-protein wheat may be difficult to find until the spring wheat harvest.



Soybean Oil

Soybean Oil Prices Rally on EPA Proposal

A May soybean crush of 149.2 million bushels, although well above market expectation, was almost 3 million bushels below last year's record for the month. With the holiday demand out of the way and production fully recovered from the 2015 drought, the seasonal increase in output is expected to build stocks back toward the five-year average by July or August. Over the balance of June, the soybean oil market may be driven by the EPA's announcement of preliminary fuel volumes under the Renewable Fuel Standard for 2018 biofuel and 2019 biodiesel. The announcement is expected to feature an increase in biodiesel requirements, which would increase domestic soybean oil usage.



Corn

Expanded Corn Crops to Keep Prices from Rising

The corn market will remain sensitive to weather heading into July. Any threat of hot and dry conditions for the Corn Belt likely will provide underlying support to the market, especially as we move through the critical yield producing period of July and August. The longer-term view is that nearby corn prices could break lower (\$3.00 to \$3.40) as we approach harvest in the US, assuming no weather issues have significantly affected the crop. Potentially large production from South America is expected to compete with US corn for export demand and pressure prices.