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Volume, not Price, Driving Canada's Food Manufacturer Sales

By Kevin Grier, George Morris Centre

According to the latest data from Statistics Canada, 2009 is shaping up to be a very good year for food manufacturing sales gains. Of interest is the fact that this growth in sales is due to higher volumes, not price increases. This think piece examines the current trends in food manufacturing, and the forces precluding higher manufacturer prices.

August sales for food manufacturing increased by 5% compared to August 2008. Total sales on a year-to-date basis also increased by 5% from January through August. This stands in sharp contrast to total manufacturing sales which declined by 19% in August and by 20% on a year-to-date basis. In fact, over the last three years, food manufacturing has been making fairly steady sales gains while total manufacturing has declined. Figure 1 shows the trends in food and the total manufacturing sector.

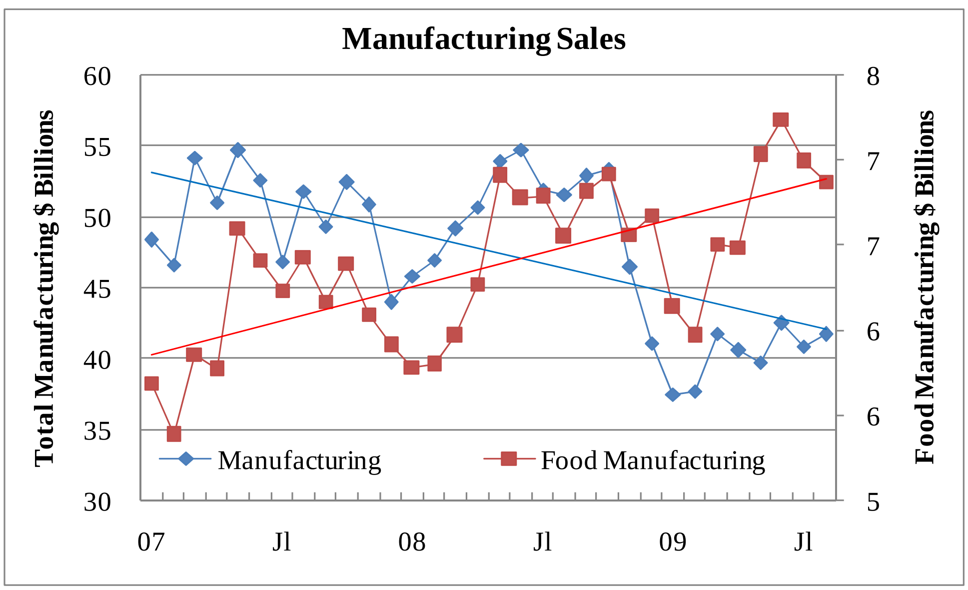

Figure 1

The two sectors are illustrated on the graph on differing vertical axes, given that the total manufacturing sector is about 6 times larger than the food sector. As can be seen, the trend line for food is increasing at roughly the same rate that the trendline for all manufacturing has been decreasing.

The general expectation is that during a recession, manufacturing in general declines while food manufacturing is either steady or improving. The downward trend in total manufacturing can be almost entirely explained by the huge decline in the latter part of 2008. This, of course, coincides with the economic turmoil of the market collapse. The trend since 2007, however, suggests that food manufacturing has been making erratic increases that are independent of overall economic conditions. In addition, the food performance during the recession has been exceptional.

With regard to relative performance, in 1999 food manufacturing represented 11% of total manufacturer sales. Through the mid-2000's, the share ranged around 11-12%, and in 2008 the share was 13%. So far this year, food manufacturing's share of total manufacturing has amounted to 17%.

Within the food manufacturing sector, on a year-to-date basis, fruit and vegetable manufacturers, as well as meat manufacturing, bakeries, and snack foods have all grown at above the food industry average. Dairy and breakfast cereals have grown at below average levels. Animal feed, grain and oil seed manufacturing, as well as soft drinks saw year-to-date sales declines.

Manufacturer Pricing Stagnates

The very strong sales increases in the food industry have been driven by volumes as opposed to pricing increases. Figure 2 shows the Statistics Canada Industry Price Index (IPI). The IPI shows the changes in prices at the industry or wholesale level.

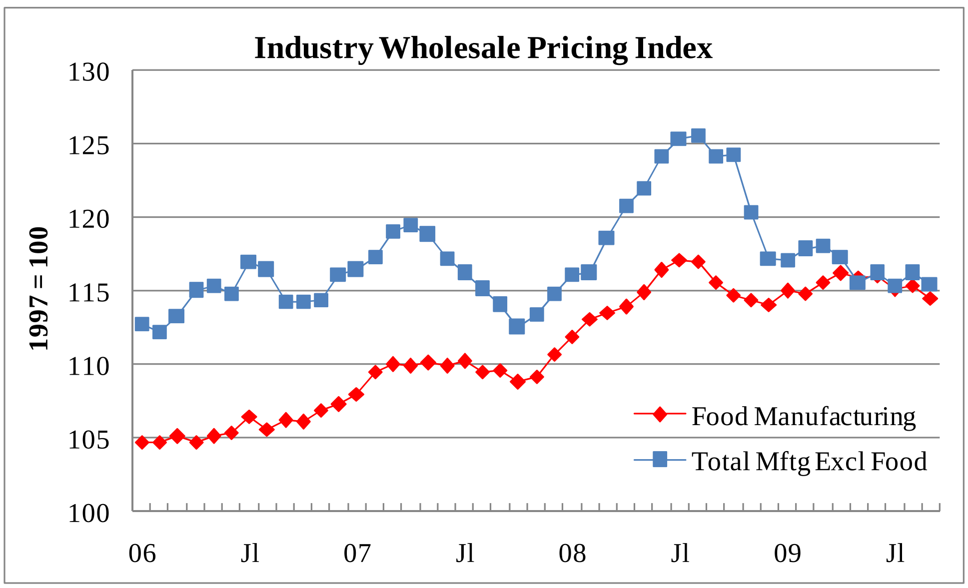

Figure 2

As can be seen, the food manufacturing price index rose rapidly from the final quarter of 2007 through July 2008. This increase corresponds with, but was less than, the general increases in commodity costs that were occurring at the same time. From July 2008 to September 2009, food manufacturers were only able to keep pricing steady at best. In 2009, on a year-to-date basis from January through September, there was no change in food manufacturer pricing compared to 2008. The flat pricing performance of food manufacturing means that the big sales increases seen so far in 2009 are due solely to volume increases.

As always, it is of interest to compare Canadian performance again the US. Figure 3 shows monthly US food manufacturing sales for 2007, 2008, and through September 2009.

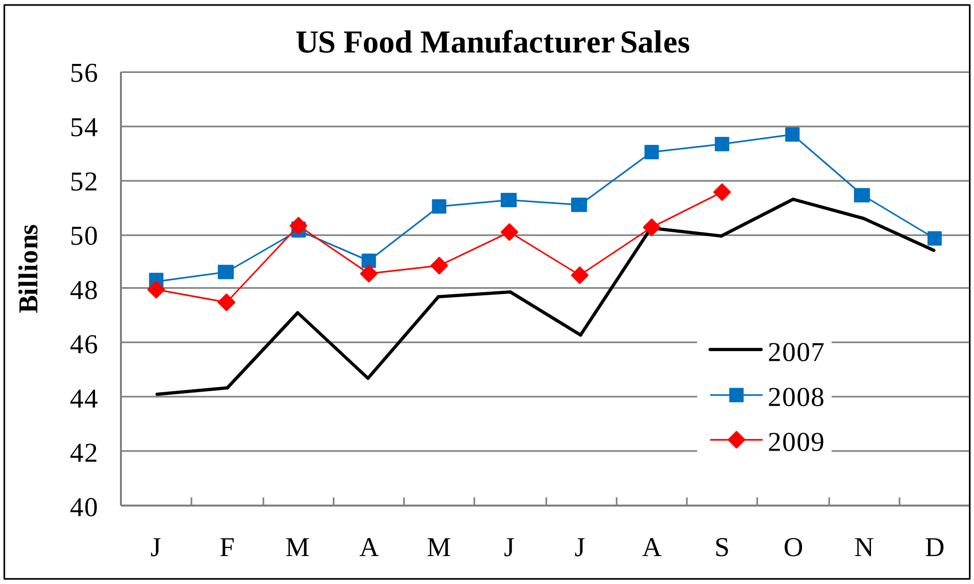

Figure 3

The growth in the Canadian food manufacturing industry during 2009 stands in contrast to the decline going on in the US food manufacturing industry. On a year-to-date basis from January through September, the US food manufacturing industry has seen total sales decline by 2.7% compared to 2008.

US manufacturers have their share of challenges when it comes to pricing. While year-to-date pricing for Canadian food manufacturing has been flat, in the US it has declined. On a year-to-date basis through September, US food manufacturers have seen prices decline by 2%. At least part of the reason for the pricing pressure in the US has been push-back from US food distributors. US grocers have made well-publicized statements about the need for manufacturers to lower prices. They are looking for payback from the big commodity-driven increases they were forced to absorb during 2008.

In addition, the US grocery industry is in the midst of recession-driven price wars in many regions of the country. The Wall Street Journal, October 20, reported that Netherlands-based Ahold, which earns about 60% of its revenue in the US, said that despite volume growth in all of its markets, sales were hit by "deflation and trading down by customers." It said that increased promotional activity continued, especially in the US. In recent months, Belgium-based Delhaize Group SA, which operates the Food Lion, Hannaford and Sweet Bay chains in the US, has -- along with US-based rivals
Supervalu Inc. and Safeway Inc. -- warned that price competition and the use of promotions is increasing.

The Journal, November 9 went on to report that the recession may be over but companies that cater to consumers believe people are digging in for a long, frugal winter. That's why Clorox is keeping the price steady on a new, improved trash bag that grips the top of the garbage can. Clorox says it wants to highlight the bag’s "greater value." Similarly, Campbell Soup recently reduced the promoted price of its V8 beverages in some markets to 2 for $5 from 2 for $6. Burger King is selling double cheeseburgers for just a dollar. Procter & Gamble and other major makers of household staples, while vowing to resist price wars, say they plan to flood stores with enhanced versions of existing products. After nearly a decade of introducing increasingly expensive items, P&G's new products will span a wider range of prices, most notably at the low end. Among its efforts, P&G is paring the price of its Cheer detergent to reposition it as a "value" brand.

Figure 4 shows US and Canadian food manufacturer pricing levels as reported by Statistics Canada and the US Bureau of Labor Statistics. Both departments use different base years. As such, the base years have been equated to 1999.

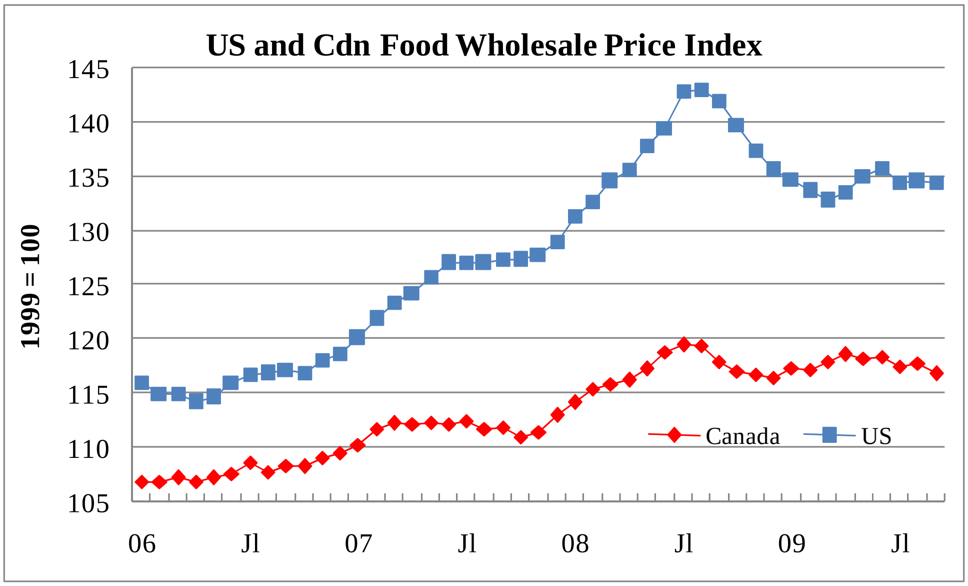

Figure 4

What is most interesting is how rapidly US food manufacturer prices rose through 2007 and 2008. The food manufacturer increases even exceed the overall commodity increases seen in Canada over the same time. US food prices increased by 12% from July 2007 to July 2008. Canadian total commodity pricing increased by just 7% over that same time period.

Exchange Impacts

When considering why there is a difference between Canadian and US food manufacturer pricing performance, the exchange rate is a good place to start. Figure 5 shows the exchange rate from 2006 through October 2009, as reported by Statistics Canada.

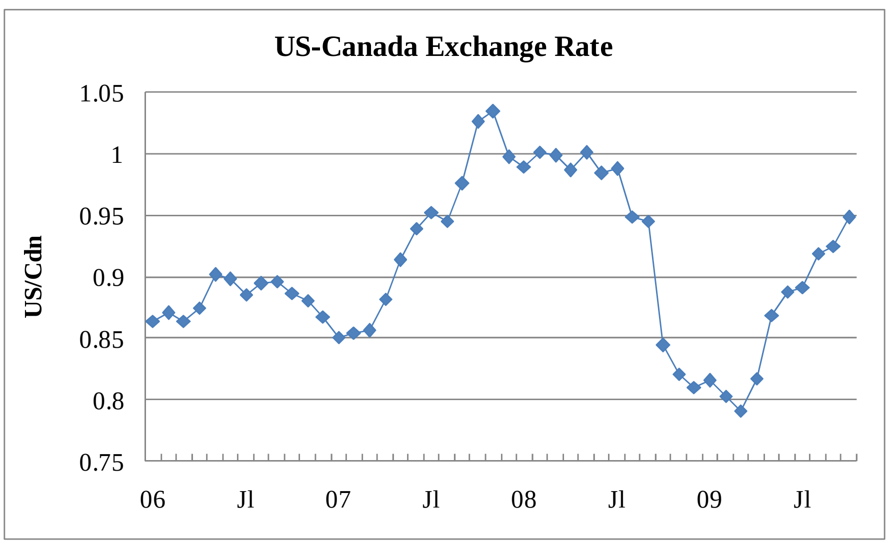

Figure 5

The premise is that the rapid appreciation of the exchange rate in 2007 and 2008 would have dampened much of the upward pressure in food prices. The appreciation pressured commodity pricing lower in Canada compared to the US. The steep depreciation of the currency in Canada in the fourth quarter of 2008 occurred too fast and was too short for it to pressure manufacturer pricing higher.

Needless to say, there are varying forecasts by the major banks on the Canadian dollar's performance in 2010 and 2011. TD Bank Financial Group's Quarterly Economic Forecast from September 2009 sees a par exchange rate in the first quarter of 2010. It also forecasts a gradual quarter by quarter depreciation from that point. They expect the exchange rate to be US¢/C$0.93 by the end of 2010 and 0.89 by the end of 2011. The Bank of Montreal's BMO Capital Markets Economics, October 23, sees a gradual appreciation from 0.99 in the first quarter of 2010 to 1.02 in the last quarter of 2011. The Scotiabank Group Global Economic Research is closer to the BMO in seeing a par currency in the future. As of the end of October, Canadian dollar futures were trading around 0.93 through 2010.

The bottom line is that the exchange rate should be a force for lower pricing. In addition, Canada's food distributors are showing more signs of following their US counterparts in competing with each other on price. This too is going to place downward pressure on manufacturing pricing. Finally, most commodities from meat to oil appear to be in a holding pattern, and there are not many signs of upward pressure on commodities for the next six months or more. As a result, Canadian food manufacturers are not likely to enjoy pricing increases any time soon.

A version of this report appeared in the November 2009 issue of Grocery Trade Review, a George Morris Centre publication. If you are interested in a free two month subscription to Grocery Trade Review, e-mail Kevin Grier at kevin@georgemorris.org