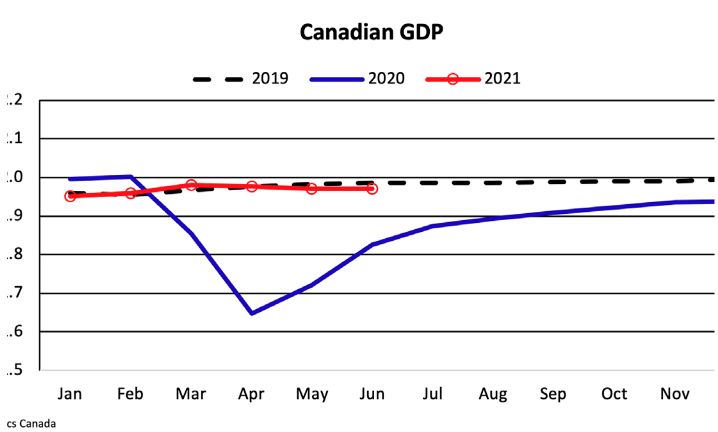
DOMESTIC MARKET REPORT | Q3 2021

REPORT FROM CANADA BEEF

Economic Outlook

Choppy is a word describing the disjointed quality of many small waves and choppy is the best word to describe the Canadian economy right now. A slackening and tensing pattern of supply chain bottlenecks and labour difficulties have translated into volatility across all commodities. The swells are seemingly transitory, a phase of realignment between supply and demand after months of imposing obstacles; these are the final lapping waves of the economic Tsunami from 2020. Due to the tremendous efforts of all hands on deck in the Canadian beef industry, the forecast ahead is for smoother sailing.

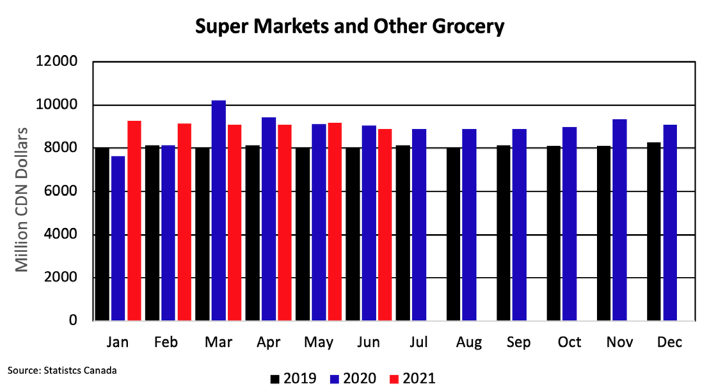
Following a stronger first quarter for Canadian Gross Domestic Product (GDP), the second quarter was a period of month after month micro-contractions. Gross Domestic Product contracted -0.3% from April to May, and down 0.1% from May to June 2021 (latest). In June 2021, GDP was 8% higher than June 2020, but 0.8% lower than June 2019 and still trending below the pre-pandemic high water mark. Choppy waters are projected throughout the third quarter as well, but by the fourth quarter 2021, analysts have projected a 0.5% increase in GDP over the fourth quarter 2019. The bounce-back effects from pent-up consumer demand have mostly played out. Economic engines are now expected to run on business investment. This is expected to bring annual GDP in 2021 up 6.3% from 2020, and a 1% increase over 2019.



An estimated 95-99% of pandemic-related employment losses have been recovered as government supports wind down this fall. Still, over 800,000 job vacancies existed at the end of the second quarter. There is less a labour shortage and more a labour reshuffling that is driving current levels of unemployment. Unemployment was at 7.1% in August 2021, down 0.4 percentage points from July and edging closer to the 5.8% unemployment rate from August 2019.

Retail Sector

Supermarket and other grocery sales have remained higher than 2019 levels for the last 18 months. Grocers were still realizing year over year sales increases early on in January and February 2021. More recently, that pace has slowed. In the second quarter of 2021, supermarket and grocery sales were down on average 1.6% from 2020, but still up on average 12.2% over 2019 levels.

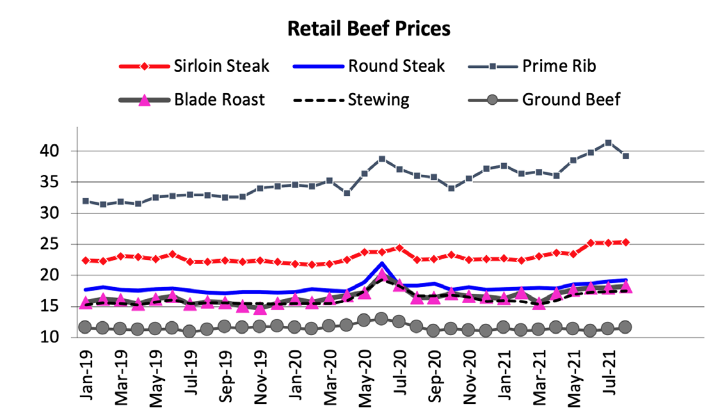


Retail sales are being supported by food inflation. Canadian forecasts exclusive to retail food were expecting a 3 to 5% increase in the overall food price for 2021. The inflation will be felt differently across the country. Alberta, Manitoba, Ontario and Saskatchewan are expected to see below average food price increases. British Columbia and the Maritimes, however, are expected to see above average food price increases. The most significant increases were predicted for meat at 4.5 to 6.5%, bakery at 3.5 to 5.5%, and vegetables at 4.5 to 6.5%. These goods are susceptible to the impacts from La Nina drought experienced this year, and the increasing national dependence on imported products that are at the mercy of rising fuel and transportation costs.

Rising food prices also result from the capital flight of the food manufacturing sector from Canada. Both family-owned operations and large multinationals are having trouble justifying their businesses here, even when they use Canadian inputs in their products. A lack of investment in the Canadian food processing sector means that retailers increasingly rely on imported food items, which contributes to the higher prices at grocery. In a globalized economy, trade should make goods and services cheaper. In a highly regulated economy, transport costs, climate change mitigation costs and packaging levies actually make goods more expensive. Large companies are able to pass on these costs to suppliers; and they trickle down through the supply chain to producers. For smaller companies, the increased cost of doing business has to be passed onto the consumer.

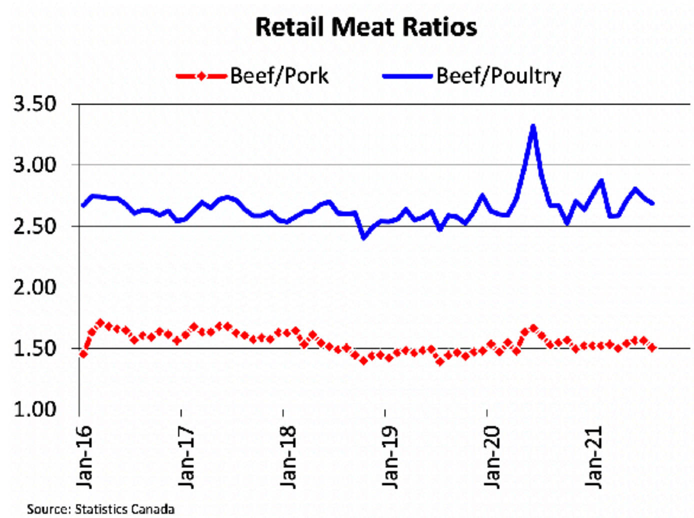
Monthly year over year food price comparisons are misleading this year given the volatility of the current economic environment. In August 2021, the Food Price Index (FPI) was up 2.7% from August 2020. January through August 2021, the FPI was up just 1.4% from the same period in 2020. It's key here to note that the FPI has consistently outpaced the Canadian Price Index (CPI) for the last 20 years. That means that food prices at grocery are not a reliable indicator of the extent of overall national inflation. The sky is not yet falling, just reflecting the transitory effects of Canada's choppy economic waters.

The retail beef price started its seasonal decline, down 1% from July 2021 to CDN$21.85/kg in August 2021. The decline was primarily driven by the retail price of the prime rib roast that seasonally declined 5% from July to August 2021. Retail beef is still more expensive than usual, however, with prices up 8% compared to August 2020 and up 14% compared to August 2019. Rising prices are being driven by higher demand at retail, especially for higher priced middle meats.



In August 2021, all major cuts were higher in price compared to August 2020, except for ground beef. The largest increase was for sirloin steak (+13%), followed by boneless blade roast (+11%), prime rib roast (+9%), stewing beef (+5%), and round steak (+5%). Both blade roasts and round roasts found counter seasonal support throughout the summer. Ground beef, while up 2% from July to August 2021, was down 1% in August 2021 compared to August 2020.

Year over year, prices for meat products in the CPI rose at the fastest pace in August (+6.9%) since June 2020 (+8.1%). Notably, this was driven by the price of poultry and pork. Producers are facing higher input costs, supply chain issues, and growing demand from restaurants for shareable products like wings that struggled for demand last summer.

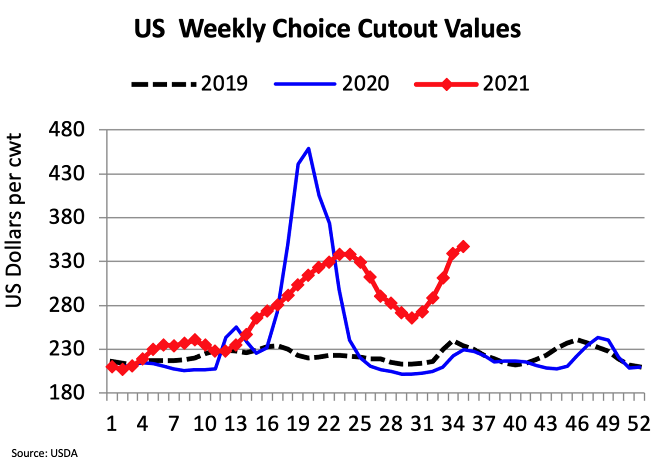


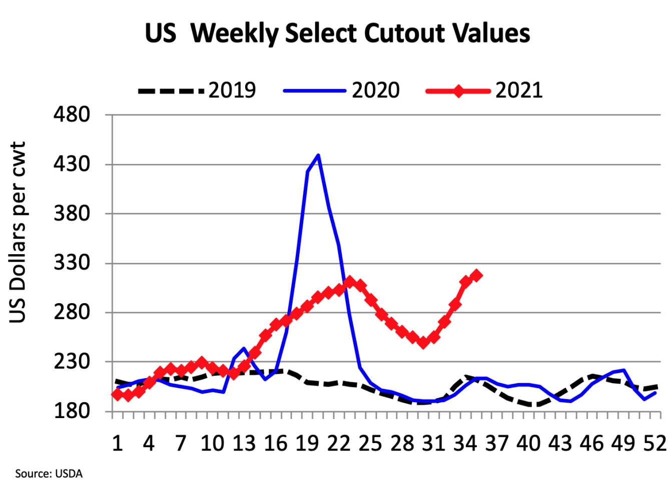
In August 2021, the retail chicken price was up 7% from August 2020. The relative price ratio of beef to chicken moved down from 2.73 in July 2021 to 2.69 in August 2021. January through August 2021, the relative price ratio of beef to chicken averaged 2.72, compared to 2.82 in the same period in 2020. In 2019, that average was closer to 2.56. Meat prices are becoming more favorable for beef, but not yet at pre-pandemic levels.

In August 2021, the retail pork price was up 9% from August 2020; to be the second highest price on record (since 1979), second only to November 2015. January through August 2021, the relative price ratio of beef to pork was an average 1.53, compared to 1.56 in the same period in 2020. In 2019, that average was closer to 1.45. Like chicken, prices are becoming more favorable to beef this year, but not yet returning to pre-pandemic levels.

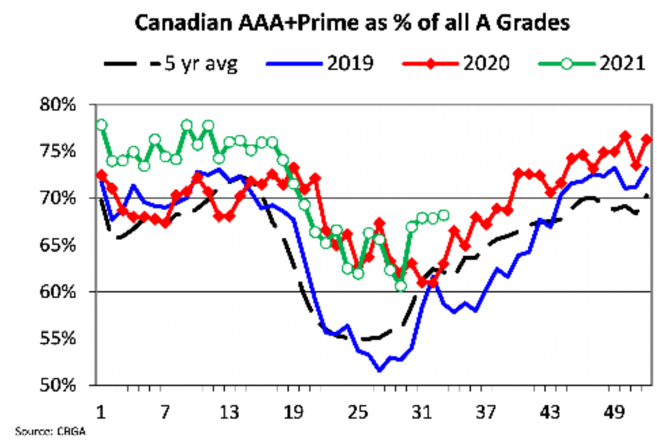
Wholesale Sector

Canadian cutout values are undelivered since March 2020, but a look to the American market can provide insight into the Canadian wholesale sector. US cutout values made an exaggerated late summer rally to rival the earlier spring peak. In August 2021, the Choice cutout was CDN$406/cwt (US$322/cwt), a whopping 48% higher than August 2020. The Select cutout was CDN$251/cwt (US$297/cwt), 47% higher than August 2020. For perspective, the Choice cutout was 38% higher and the Select cutout was 49% higher than the five-year average for August. Cutout prices seem to have peaked for the time being and are likely to head lower into September. American buyers may have been eager to purchase holiday product long before the holiday months this year.





The declining retail price this August in Canada suggests that Canadian wholesale values may not have followed the same late summer rally experienced in the US. With prices unreported since March 2020, this is only speculation. If true, we may expect to see prices strengthen in Canada during the holidays, more so than what may occur in the US. If the late summer rally did occur, expect to see retail prices supported this September. In Canada, more Prime and AAA is available as carcass weights stayed above average January through June. Canadian production of Prime and AAA at 70.1% of all 'A' grades (January through August) is up 11% from the same period in 2019 (64.1%) and the five-year average (63.7%).



Food Service

Canadians love to travel and spend their food service dollars abroad. This summer marks the second consecutive summer that these dollars have remained locked into local economies. Local travel and return to work appear to have supported the limited service (e.g. fast-food) sector to near steady sales with pre-pandemic levels. The remainder of the food service sector is still struggling though. Restaurants have been hit hard again this year with restrictions and customer fears about the perceived risk of going out.

Food Service Sales in Canada	June 21st 2020	June 21st 2019
Total (Excluding drinking establishments)	+25%	-20%
Special Service	+57%	-45%
Full Service	+46%	-25%
Limited Service	+22%	-1%

Total food service sales in June were up 32% from June 2020, but down 16% from June 2019. Subtract drinking only establishments, and food service sales were up 25% from

June 2020 but down 20% from June 2019. Special service (e.g. the catering and stadium business) was up 57% from June 2020, but down 45% from June 2019. The story is similar for full service (e.g. dine-in restaurants), whose sales were up 46% from June 2020, but down 25% from June 2019. These numbers are disappointing considering the investments the full-service sector is thought to have made to refresh business models and provide more dine-out options. Only limited-service establishments have come close to sales comparable to 2019. Limited-service sales in June 2021 were up 22% from June 2020, and down just 1% from June 2019.

As the Canada Emergency Wage Subsidy is set to expire September 25, 2021, and patio season winds down, restaurant capacity is likely to be negatively impacted. Full-service restaurants may be forced to borrow-more or invest and focus more on dine-out and online orders to stay afloat during the colder months, if they haven't done so already. This may lead to fundamental and semi-permanent shifts in employment, cutout values and in the way families gather and celebrate occasions. In the near term, there won't be as many jobs in the sector. Additionally, the cutout may be impacted because cuts demanded by the sector may support more dine-out friendly offerings. Both round and blade roast retail pricing increased counter seasonally this summer. This could be because there was more competition from food service to support wholesale values for these products. Full-service will have to adjust to changing and entrenching consumer behaviors. For example, a University of Guelph study examined whether Canadians' eating habits had changed since staying home. It showed that 60% reported making more meals from scratch, 70% spent more time cooking, 55% ate more meals with children and 50% involved their children in meal preparation more often. These are wholesome activities that families may not tire of for quite some time.

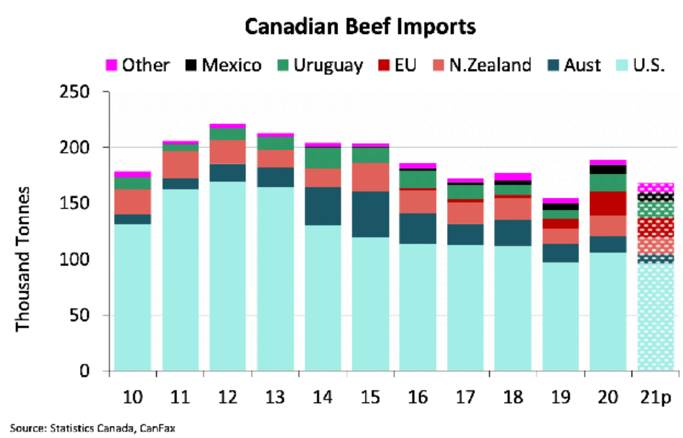
The transitory food inflation in the economy is also putting pressure on families and is unsupportive to food service. Many more families will be doing more cooking and will become more disciplined to combat this inflation.

This does not bode well for the food service sector. It is estimated that pre-pandemic ratios of retail to food service buying were 62:38, and that the ratio dropped as low at 91:9 during the pandemic and is currently around 74:26.

Imports

Canadian beef imports from January through July 2021 were down 16% in volume and 14% in value from last year. Import volumes are down from the US (-10%), the EU (-6%), the UK (-40%), New Zealand (-23%), Uruguay (-27%), Australia (-47%), and Brazil (-13%). Import volumes increased from Mexico (3%) and Argentina (2478%). Recall that imports in 2020 were elevated due to supply chain disruptions in domestic meat production. Beef imports were 22.8% of domestic consumption in 2020 due to a heavy reliance on imports in the second quarter of that year. For 2021, that number is projected to be to 19.9%, well below the 10-year average at 24.5%.

Import volumes are projected to end the year down 11%. The U.S. is expected to capture a 1.2% increase in market share, with Australia's market share declining to 5% in 2021 from 7.8% in 2020. Mexico's market share is also projected to increase by 0.3 percentage points, to 4.6% in 2021. Imports remain lower than average in part due to the enormous efforts made by beef producers and processors in Canada to keep a steady and quality supply of beef for Canadians.



Source: Statistics Canada, CanFax