Spain’s food sector under pressure from inflation and climate change

Food prices in Spain remain elevated due to high inflation and adverse weather conditions, which are having a detrimental impact on harvests. Could the sector see some improvement in 2024?

In this bundle

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Commodities, Food & Agri | Spain

Spanish food and agriculture sector set for a post-inflation recovery

Production in Spanish food manufacturing has come under pressure this year, but the outlook for 2024 looks brighter

Extreme weather conditions in Spain have affected the harvest of certain food products

Spain's food sector feels the pinch

Spain's food sector – while less cyclical than sectors such as tourism or construction – is not immune to the current economic slowdown and rising inflation. It has also been impacted by extreme weather conditions that have affected the harvest of certain food products.

The impact on Spain's food processing sector has been significant – up until July, production levels were showing a 2.5% decline from the previous year, due to reduced domestic and international demand.

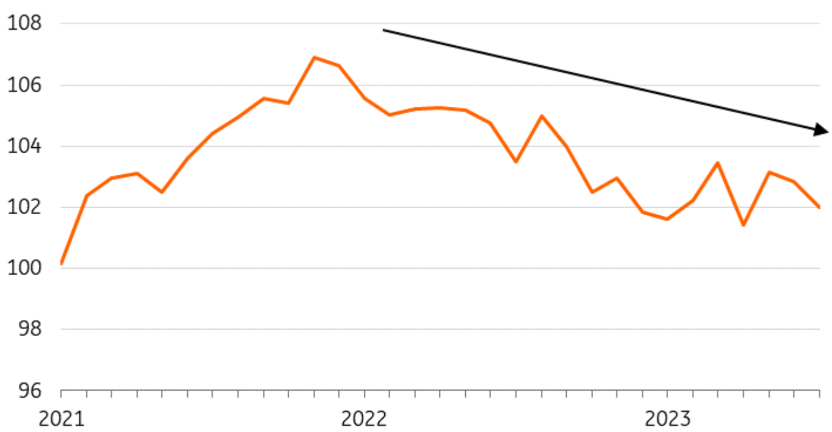
Signs that consumers have been buying less have been around for a while. Food and beverage retail sales volumes decreased by 1.7% in 2022 and remained under pressure in the first quarter of 2023, according to the national statistics agency INE.

Consumer spending on food and drink has likewise been hit across Europe, although unlike other EU countries such as Germany and the Netherlands, food retail sales volumes in Spain have been picking up since the spring, partially thanks to a strong influx of tourists.

While we expect Spain's food sector to go into contraction, we see diverging trends between subsectors. Output at processors of vegetable oils, fresh produce and grain mills have shrunk more sharply as they have suffered from weather and harvesting conditions. The fish processing industry has been affected by sharp price increases for energy and operational costs, while higher selling prices curb fish consumption. In contrast, output in some other subsectors (meat, bakery, beverages, dairy) has shown much more resilience. Basic food products are generally less price-sensitive than other food products.

Production in Spanish food manufacturing has been falling since 2022

Index of production, seasonally and calendar adjusted data



Source: INE, ING Research

Food price increases are slowing down

Despite the ongoing challenges, there are hopeful signs on the horizon. In a recently published ING report on food inflation trends in both Europe and the US, we wrote about how food price rises are subsiding on a month-on-month basis in Europe, although the pace differs per country. Spain seems to be lagging somewhat. A larger share of Spanish food producers plan to raise their prices further compared to their German and French counterparts.

Although Spanish food inflation is expected to continue to fall, it will ease more slowly than in other eurozone countries. Nonetheless, this will still provide some respite for Spanish consumers who have faced a significant 25% increase in their grocery bills over the past two-and-a-half years.

Higher food prices take their toll on the family budget

Increased food prices are forcing Spaniards to spend an ever-larger chunk of their budget on food and groceries. Almost two-thirds (63%) of Spaniards indicate that they spend a greater proportion of their income on food today than they did five years ago, according to a survey by IPSOS conducted in June on behalf of ING.

More than half (53%) of Spaniards expect the share of their income going to food and groceries to rise even more in the coming years. The Spanish figures match those of Belgium and the Netherlands, which were also included in the survey, but are still much lower than those in

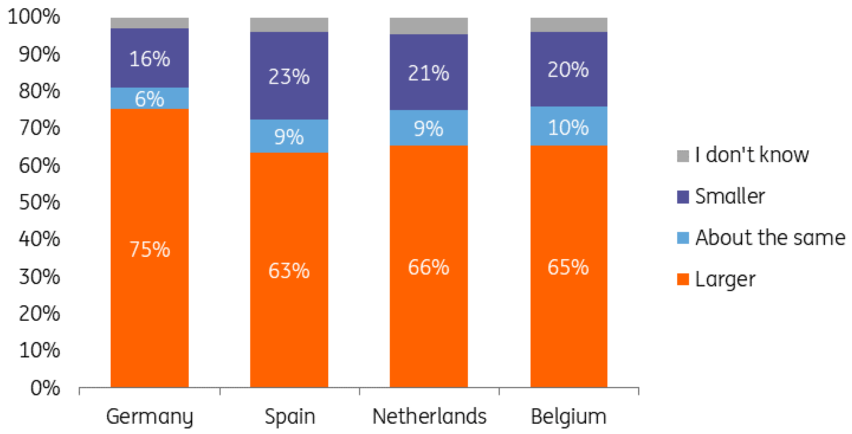
Germany.

To keep costs down, many consumers are changing their shopping behaviour. Within the meat category, poultry and frozen meat sales are growing and replacing more expensive beef. In dairy, some leading European producers reported declining sales volumes in the first half of the year, with value-added products like quark or speciality cheeses showing a higher elasticity than staples like milk.

Meanwhile, higher prices for fruits and vegetables tend to lead to lower sales volumes, in part because consumers opt for processed products instead of more expensive fresh products. Sales of fresh fruits, vegetables and potatoes dropped by around 4% in Spain (up until May) and by 2% in the Netherlands (up until June) for example.

Consumer survey shows consumers now spend a larger share of their income on food...

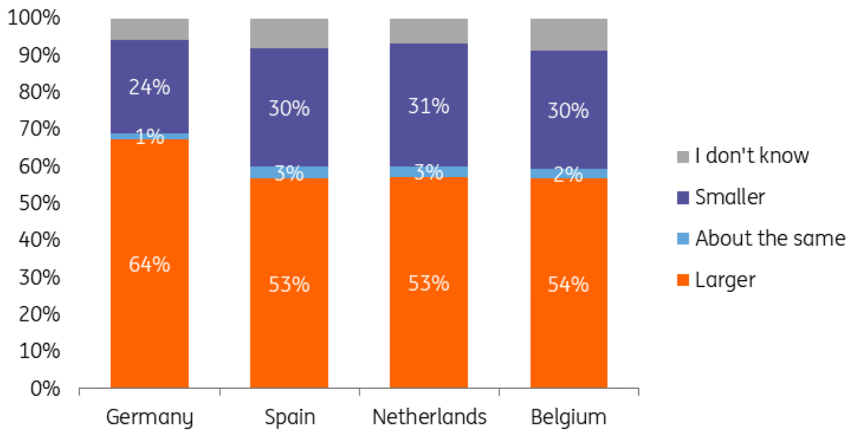
'Compared to five years ago, the share of my net income going to food and groceries is...'



Source: ING Research

... and the majority of those polled also expect to spend a larger share on food in the future

'I expect that within five years, the part of my net income that goes to food and groceries will be...'



Source: ING Research

The outlook for household consumption will gradually improve

Private consumption was the main growth driver for the Spanish economy in the second quarter of 2023. This was due to a combination of easing price pressures and rising nominal wages, which had a positive impact on household purchasing power. While we think consumption will continue to make a positive contribution to growth, we expect tighter financing conditions and weaker labour market dynamics to dampen consumption somewhat in the second half of 2023.

Next year, when the headwinds from these factors subside and nominal wages again rise faster than inflation, consumption may pick up further. For Spain, we expect average wage growth of 4% in 2023, followed by another 3% in 2024, both above inflation.

Under this scenario, Spanish household food consumption will be able to recover cautiously in the coming year. This offers branded food producers an opportunity to regain lost market share and volumes. The gradual improvement in household finances, combined with an anticipated upturn in promotional activities by both food manufacturers and retailers, is expected to boost food sales volumes.

Wage growth is expected to surpass inflation in Spain, France and the Netherlands

Forecasts for wage growth and inflation

	2023		2024	
	Wages	Inflation	Wages	Inflation
Spain	4.0%	3.6%	3.0%	2.7%
France	5.5%	5.5%	4.2%	2.7%
Netherlands	5.8%	4.3%	5.6%	2.1%

Source: ING Research, Funcas, Banque de France, CPB

Spanish food export volumes take a hit in 2023

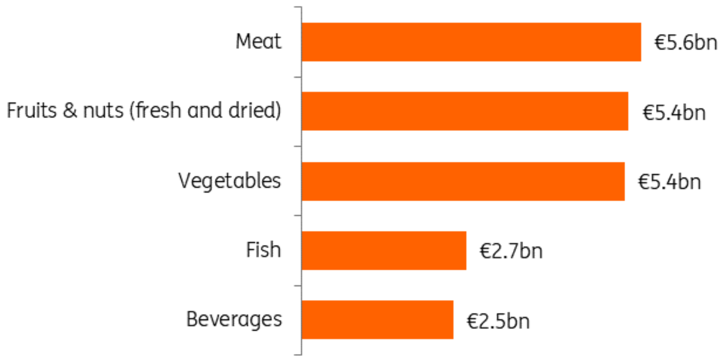
In addition to domestic food consumption, pressure on food exports is also increasing. While the value of Spanish food and beverage exports rose by 8% to €31bn in the first half of 2023, this increase was driven solely by higher prices, as export volumes contracted by 10% over the same period. Both lower foreign demand and lower domestic supply following exceptionally dry and hot weather have weighed on Spanish food exports.

Meat exports in particular have experienced problems due to a decline in pork exports to non-EU markets, such as China. At the same time, increased production costs and unfavourable weather conditions resulted in a decline in the trade of fresh fruits and vegetables. Exports of essential products such as citrus, peppers, tomatoes and strawberries all fell in the first half of the year.

It is very likely that volumes will remain under pressure until 2024 considering that many producers expect consumer demand to remain muted during the final stretch of this year. Meanwhile, on the supply side, forecasts for the upcoming citrus fruit and olive oil campaigns point to another disappointing year in volume terms. Given Spain's role as a major food and beverage exporter, lower foreign demand is having a significant impact on Spanish food producers.

Meat, fruits and vegetables are Spain’s main food export categories

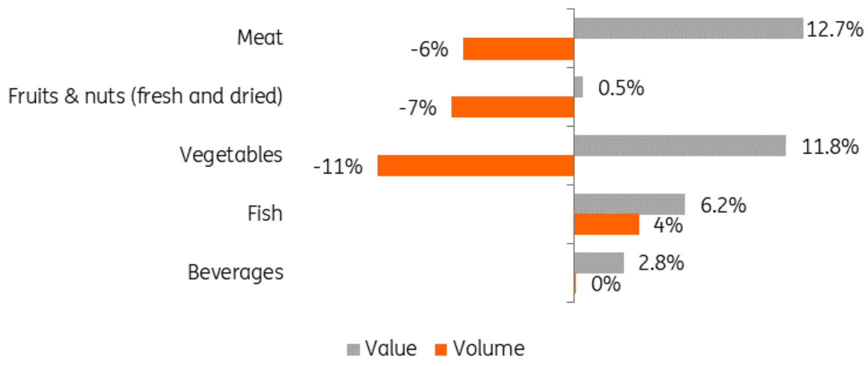
Export value in billion euros in the 1H23



Source: Eurostat, ING Research

Export value is generally up, but volumes have taken a hit

Growth in 1H23 compared to the same period last year



Source: Eurostat, ING Research

Food and agriculture will weigh on economic growth this year

The Spanish food and agriculture sector currently faces several economic challenges, including high input costs, unfavourable weather patterns, consumers whose purchasing power took a major hit last year, and sharply rising interest rates. Consequently, we expect production in the sector to contract by 1.5-2% this year. Due to slowly cooling inflationary pressures, continued wage growth, and peaking interest rates, the sector will likely be able to make up some ground next year.

Of course, a decline in the food and agriculture sector also weighs on the country's broader economic outlook, as the sector is a solid contributor to Spain's GDP. If we look at the aggregation of agriculture, fisheries, food and beverage production and wholesale food and agricultural products, together they account for about 7% of economic activity in Spain. Since we expect a growth rate of 2.2% for the whole Spanish economy this year and 1.1% next year, the Spanish food and agri sector will thus make a strong negative contribution to the Spanish GDP figure for this year.

Food and agri subsectors account for 7% of the Spanish economy

Share in value-added output, 2021

Source: INE, ING Research

Climate change is the biggest challenge

Although inflationary pressures remain high and will remain stubborn for the rest of the year, they will gradually normalise. The biggest challenge for the sector going forward is dealing with the impact of climate change. Changes in weather patterns are permanent and will continue to require additional action from food producers and policymakers.

With water being an indispensable resource for agriculture and food companies, there is a clear urgency to invest in measures that help to optimise water use throughout the food supply chain. For the livestock sector, measures that help to reduce heat stress on animals are equally important.

Moving up in the supply chain and diversifying sourcing are additional strategies to adapt to weather-related risks and cater to the needs of customers.

The current drop in Spanish agricultural production is being partly offset by importing more products such as tomatoes and oranges from other countries, such as Morocco and Egypt, which shows that such diversification is already taking place.

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Spanish food inflation is past its peak but will remain elevated

Spanish food inflation is falling but will remain high for longer than in other eurozone countries

Spain is the largest producer of olive oil in Europe, but has seen prices accelerate in recent months

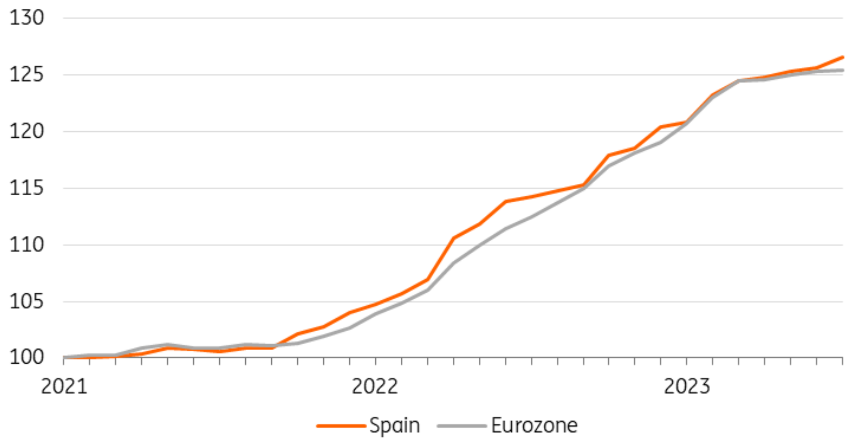
Spanish food inflation will continue to fall but slower than in other countries

The increase in Spanish food prices has already dropped significantly in recent months, from a peak level of 16.6% in February to 10.8% in July. There are signs that this downward movement will continue in the second half of the year.

Prices of many agricultural commodities have eased, and gas and electricity prices have fallen sharply since last summer. The selling price expectations among producers of food and non-alcoholic beverages, which are a good leading indicator for food inflation, have continued to ease over the last few months.

Food prices in the eurozone seem to have reached a plateau, but not in Spain

HICP index of food and non-alcoholic beverages up until July, January 2021 = 100



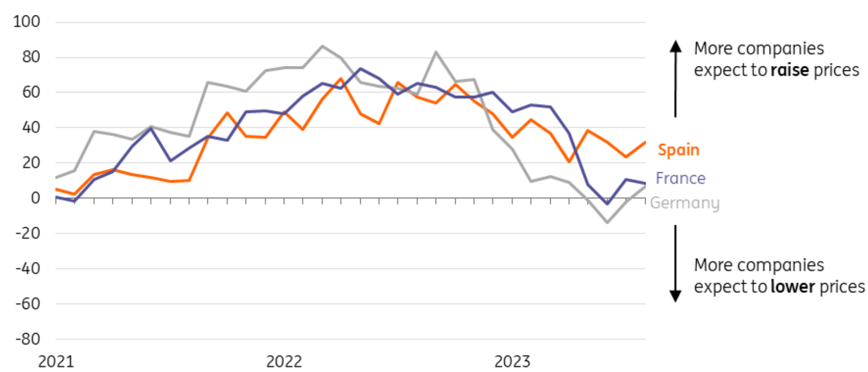
Source: Eurostat, ING Research

However, the cooling of food inflation is likely to unfold more slowly in Spain than in other countries. As the chart below shows, Spanish food producers are currently more inclined to raise prices than their French and German counterparts. This can be explained by local conditions. The extremely hot and dry weather in Spain has led to much lower domestic availability of ingredients such as wheat and olive oil, which mainly drives up the input costs of Spanish food producers.

In addition, the entire food production chain in the eurozone continues to face cost increases due to rising wages and fuel prices, making food transportation more expensive. Producers will continue to pass these on to the end customer over the coming months. All these factors will ensure that food inflation remains stubbornly high, hovering around 7-8% by the end of this year.

Spanish food manufacturers are still more inclined to raise prices

Expectations regarding sales prices in the months ahead, balance of survey answers



Source: Eurostat, ING Research

High food inflation will continue to put upward pressure on headline inflation

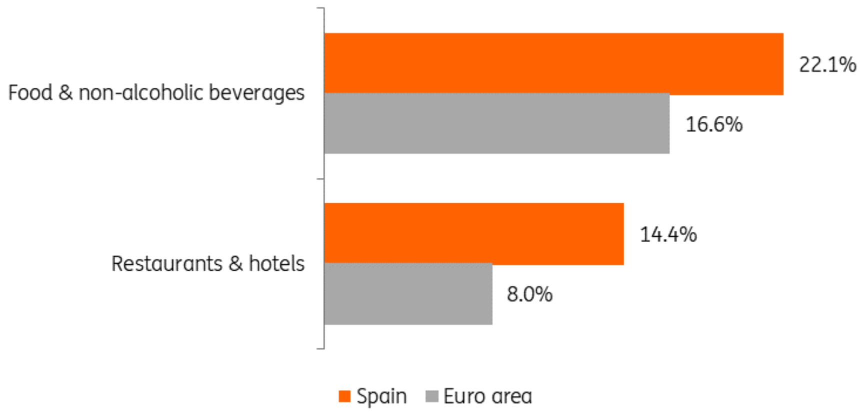
The contribution of food inflation to headline inflation will be higher in Spain than in other countries. Spanish food prices not only tend to cool off more slowly than in other countries, but they also have a greater weight in the overall inflation basket.

Spaniards generally spend a larger share of their income on food than other eurozone countries: food and non-alcoholic beverages weigh 22% in the inflation basket, compared with only 17% for the euro area.

Besides this direct effect, there are also stronger indirect effects. For instance, high food inflation will also trickle down to other components of the inflation basket, such as the restaurant and hotel component. This has a weight of 14% in Spain, well above the eurozone average of 8%, due to the larger tourism sector. While much of this bill will fall on foreign tourists, it does exert additional upward pressure on headline inflation.

Food has a greater weight in the Spanish inflation basket compared to the euro area

Relative weight in total inflation basket



Source: INE, ING Research

Olive oil is almost twice as expensive as in early 2021

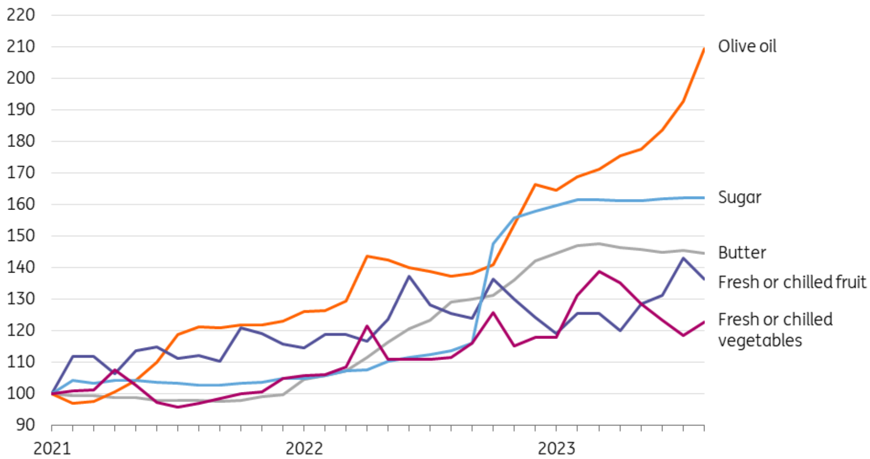
The prices of many staples have risen sharply since early 2021. Fruit, for example, has become 36% more expensive on average, while the price of olive oil has more than doubled since early 2020. For several food products, the sharpest price increases appear to be behind us. For example, the average price of vegetables has already fallen slightly, while the prices of sugar and butter seem to have stabilised in recent months.

However, for other products, such as olive oil, prices have accelerated recently. Spain, the largest producer of olive oil in Europe, had a poor harvest during the last campaign, and the outlook for the upcoming harvest is also poor.

Hot weather and a lack of rain also negatively affect the harvest of water-intensive crops such as fruit, which could push prices even higher in the coming months. Fruit is already much more expensive these days, especially the variants that need a lot of water such as citrus fruits, almonds, grapes and pomegranates.

Pressure on olive oil prices continues, but eases in some other categories

Evolution of Spanish consumer prices of some food products



Source: INE, ING Research

Food prices will remain volatile over the next decade

Although the pace of price increases is starting to slow somewhat in the short term, we expect food inflation to remain more volatile in the next decade than in the previous one. Global warming and extreme weather events, such as prolonged drought, extremely high temperatures and short-lived heavy rainfall, make crop yields and quality much more volatile, temporarily drive up production costs, and can cause disruptions in agricultural supply chains.

Volatility has been further fuelled in recent months by some countries declaring export bans, due to a disappointing harvest, to slow down the rise in domestic food prices. Morocco, for instance, restricted tomato exports in February and India imposed restrictions on rice exports and a 40% export duty on onions. Although they may slow down domestic price increases, these export restrictions drive up prices even further in importing countries.

Spain is also particularly vulnerable to climate change. A recent United Nations report shows that the Mediterranean region is a climate change hotspot as it is warming 20% faster than the global average. Coastal areas in particular face increased disaster risks such as flooding and erosion, and the salinisation of river deltas and aquifers makes food production more uncertain. In agriculture and food production, both climate change adaptation and mitigation measures will be required, which will put upward pressure on food prices.

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