COFFEE REPORT Central America November 2021

Despite improvements in labor and income, the coffee sector's recovery remains slow

KEY MESSAGES

- The coffee sector is currently continuing to struggle with lingering impacts of the unprecedented challenges of 2020. However, as COVID-19-related restrictions have scaled back, vaccination schedules progress, and producers take advantage of lessons learned in the previous harvest, labor opportunities are expected to rebound to slightly below pre-pandemic levels.

- Up until September, the coffee sector has not benefitted from recent increases in international prices, as the sharpest rise occurred in July after most of the 2020/2021 harvest had already been sold. Should sale prices continue at elevated levels through the upcoming harvest, income for producers will increase only enough to recover from last year's shocks but not sufficiently to overcome the multiple, compounding shocks of recent years.

- The regional coffee production for the crop year 2021/2022 is expected to be two percent below from the previous year, mainly driven by a decrease of 12 percent in Honduras' production, according to USDA estimates, as the rest of the countries expect modest increases. This reduction is a combination of the negative effects on crop management due to the lack of economic sustainability for several years, the aftermath of hurricanes Eta and Iota, irregular rainfall during this year, and an increase in the incidence of coffee rust.

BACKGROUND

The coffee sector in Central America has had several shocks over the past decade, including a coffee rust epidemic, the overall downward trend in sales prices since 2011/2012, a lack of economic incentives and political support for, and mismanagement of, the sector across the region, political uncertainty, the COVID-19 pandemic, and impacts of climate change, including two consecutive hurricanes last year. These shocks have largely negatively impacted coffee production, however, the sector is a dynamic component of the local economy and continues to be a source of income for a substantial share of the rural population and generates more than 2.5 million USD annually in foreign exchange transactions from regional exports. Overall, it represents between 1.3 and 8.2 percent of GDP within the region.

The role of coffee production and its commercial dynamics is vital to understanding the livelihoods and food security of the region's population, particularly the poor and very poor socioeconomic groups. Throughout the region, more than 2 million people are involved in its production. Laborers depend heavily on income earned during different stages of production, especially the harvest, which supports access to food and other basic needs throughout the year. According to the volume of production, Central American production ranks as follows, from highest to lowest: Honduras, Guatemala, Nicaragua, Costa Rica, and El Salvador.

According to the International Coffee Organization (ICO), the region's 2019/2020 production reached 18.98 million 46 kg bags, accounting for 8.8 percent of global production, which represents a decrease of 8.4 percent from the 2018/2019 season. For the 2020/2021 cycle, the ICO estimates the production for Central America and Mexico to decrease by 2.1 percent from the previous year and the United States Department of Agriculture (USDA) estimates total production to be 18.21 million 46 kg bags. 2020/2021 production was constrained by impacts of previous years and further affected by two main factors: (i) mandatory lockdowns and social distancing put in place to contain COVID-19 infections, as these measures hindered maintenance and harvest activities; and (ii) the above-average 2020 rainy season, which concluded with the landfall of hurricanes Eta and Iota in November 2020. High cumulative rainfall throughout the second 2020 rainy season favored the development of pests and diseases, including coffee rust, and torrential rains and strong winds from the hurricanes caused floods and landslides, resulting in significant damage to crops, to the road access system for harvesters, transporters, and traders, and to the production infrastructure (processing facilities, treatment ponds, drying patios, etc.). Guatemala, Nicaragua, and Honduras reported decreases in production of 16, 15, and 12 percent, respectively, when compared to the previous year. In addition, exports from the region from October 2020 to June 2021 fell by 1.3 percent to 12.8 million bags, compared with the same period during 2019/2020, with Honduras and Nicaragua recording the largest reductions of export volumes during this period of 6.1 and 9.4 percent, respectively.

GLOBAL SITUATION

Last year, the main shock affecting the global coffee sector was related to the COVID-19 pandemic, but as vaccinations roll out and government restrictions loosen in major consumer markets, economic activity is increasing and demand, including for coffee, is returning to normal. International prices and commerce have responded positively to these changes, with global exports from all exporting countries to all markets increasing by 4.1 percent in June 2021 compared to the year before and approaching pre-pandemic volumes, reaching a total of 11.2 million 60 kg bags (14.93 million 45 kg bags). Global consumption is rebounding; for the crop producing year 2020/2021, ICO projects 167.58 million bags, representing an increase of 1.9 percent from the previous year. As for the total production for the 2020/2021, it remains unchanged at 169.6 million bags, representing a slight increase of 0.3 percent from the coffee year 2019/2020; although still 0.8 percent below the pre-pandemic levels. For 2020/2021, an excess supply of 2.02 million 60 kg bags relative to demand persists in the global market, approximately half compared to the previous year. This decrease represents a significant improvement considering the interest in balancing the market and producing favorable international prices.

Prices increased in July 2021, especially for Arabica, which hit its highest value since November 2014, driven by the decrease in the current and expected supply of coffee from different origins. The major concern now comes from the drought and severe frosts that occurred in Brazil. As the world's largest producer, the frosts' impact on world production increases both market volatility and international prices. The monthly average of the ICO composite indicator reached 181.57 USD cents/lb in October 2021, representing an increase of 71.5 percent from October 2020.

REGIONAL PRODUCTION

Coffee production in Central America is mainly undertaken by small-scale producers, defined as those who produce fewer than 444.44 45-kg bags and/or have a productive area amounting to less than 2.1 hectares. This is especially true in Guatemala with 98 percent of the producers being small-scale. On the other hand, the major regional producer, Honduras, reports a smaller share with 87 percent of producers being small and medium-scale. Medium-scale producers are classified as those who produce between 444.44 and 2,222.22 45-kg bags and/or have a productive area of 17.5 to 35 hectares.

Table 1. Total coffee production (000 of 45 kg bags)

	Honduras	Guatemala	El Salvador	Nicaragua	Costa Rica
2011/12	7,843	5,134	1,552	2,925	2,441
2012/13	6,248	5,017	1,653	2,498	2,430
2013/14	6,111	4,252	687	2,746	2,069
2014/15	7,024	4,413	887	2,530	1,967
2015/16	7,714	4,546	753	2,841	1,920
2016/17	9,943	4,912	813	3,407	1,829
2017/18	10,080	4,978	1,013	3,523	2,081
2018/19	9,537	5,342	1,015	3,839	1,902
2019/20	7,908	4,808	881	3,843	1,962
2020/21*	8,315	4,199	692	3,037	1,963
2021/22*	7,333	4,627	704	3,184	1,980

Source: *International Coffee Organization*; * Estimates from the United States Department of Agriculture (USDA) in May 2021.

The USDA estimated in its May reports that regional production for 2020/2021 will be 18.21 million 45-kg bags, while for the 2021/2022 crop production year, which starts October 1, a two percent lower production of 17.83 million 45-kg bags is expected. Contributing to this declining trend are COVID-19-related restrictions, which will continue to constrain production, through reduced labor demand and lingering impacts of hurricane damage across the region. The impact of low international prices for much of the pandemic continues to be felt throughout the region, limiting the income generation and the investment capacity of the growers. Additionally, some are considering or implementing livelihood changes with more favorable profit margins, even when these activities could have a high social cost, such as migration to cities or other countries, or a negative environmental impact, with the substitution of the coffee forest with other less environmental-friendly crops. Beyond regional trends, there are also country-specific factors that are impacting production and, consequently, labor opportunities in the region, which can ultimately improve or hinder the food security of households whose livelihoods depends on the sector.

In Guatemala, the area planted with coffee is expected to increase slightly. However, this is mainly due to previously planted trees reaching maturity and is despite the advanced age of farms and limited efforts of certain producers to establish new plots, as they lack the capacity to recover from hurricane-related damages or to invest in expanding their farms.

In El Salvador, the coffee sector has been facing financial and political constraints for several years, which has caused a sharp decline in its production and excess household debt of more than 230.4 million USD. These conditions have reduced access to inputs, farm level work, renovations of old coffee plantation inventory, and the seizure of farms by banks after the last extension to suspend them expired on May 31, 2021. After years of limited government support, the coffee sector welcomed the launching of the National Coffee Policy in May, which is aiming to promote a sustainable production with renovations on 50,000 *manzanas*[1] (mz) (35,250 Ha) and other agricultural actions, support technology through the creation of a coffee research institute and re-structuring the debt to provide financing sources and investment options. Nonetheless, these changes will not come in time to influence the yields of the following harvest. One additional constraint for crop management activities and labor flows in this country is the tight territorial control of gangs, which often resort to violence in enforcement.

Although governmental and institutional support, including the coffee institutions, in Honduras is high and has helped boosted productivity in recent years, production projections are calling for a sharp decrease of 12 percent in the upcoming harvest. Despite the extension and additional funding of the Coffee Bonuses Program to support with fertilizers to small and medium farmers, the coffee sector is weakened due to years of low prices, which limited the possibility of investment from producers. Additionally, currently the sector is struggling with on-going post-hurricane road infrastructure rehabilitation and an increase in the incidence of coffee rust and other diseases nationally. By the end of November, the average coffee rust incidence in susceptible varieties is forecast to continue growing above 10 percent, and for some departments this will reach values above 15 percent. Additionally, below-average and irregular rainfall since June has generated problems in the formation of fruits, which will inevitably reduce yields and the quality of remaining coffee cherries.

Households in Nicaragua, on the other hand, are not only facing the challenges of recovering from post-hurricane damages, which USDA estimates impacts at least 5 percent of the country's planted areas, but are also dealing with stagnant investment due to limited access to credit, causing the lack of maintenance of plantations. The political environment also negatively influences the options the sector has for investment and commerce.

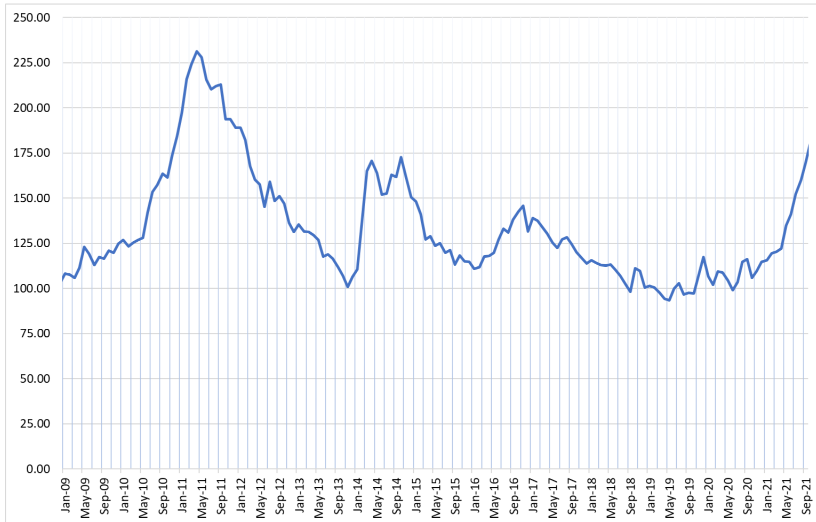
The number of coffee growers is also continuing to decline in Costa Rica despite their rich coffee producing history, with a reduction of more than 18,000 producers (or 38 percent) since 2009/2010. Last year, the production was not as high as expected due to the restrictions related to COVID-19, as laborers (mostly migrants) arrived late to the farms, hindering the collection of the coffee cherries. This year, even with continued uncertainty around COVID-19, the forecast is more positive as the flowering followed a normal pattern, leading to a prolonged and disperse harvest that could allow for social distancing and staggered migration for labor.

[1] Local area measure of 7,000 m^2 or 0.7 hectares.

Irregular rainfall distribution in the second rainy season through November could be conducive to a heightened incidence of coffee rust and other diseases. Additionally, the direct or indirect influence of a tropical storm event has the potential of causing damages that directly impact the production and the transportation and processing immediately after the harvest.

EMPLOYMENT AND INCOME GENERATED BY THE COFFEE SECTOR

Figure 1. Monthly average ICO composite price (2009-2021). USD/45 Kg bag



Source: ICO, 2021,

Although coffee production requires labor throughout its entire cycle, up to 70 percent of its demand occurs between October and February, during the harvest. The nature of this labor depends on the size of the producer and the economic conditions, as the smallest growers rely mostly on unpaid labor from their immediate family members, while small and medium growers might opt to rely on labor from relatives and neighbors as a cost saving measure as opposed to paying and hiring staff to support them. However, these measures can negatively impact coffee households by reducing educational possibilities of children and youth employed within the family. Nonetheless, the coffee sector is still highly dependent on hired informal and migrant labor to collect the beans. The flows of migrants may occur between different regions within the same country or between countries, depending on the location of the farms and the differences in the exchange rate and the daily wage. Last year, COVID-19 restrictions regarding travel and social distancing posed a challenge for the migrant population and their employers, as transportation and cross-border regulations had to be met and conditions in farms had to be modified. Costa Rica and, to a lesser extent, Honduras are the countries which rely more on international laborers.

In the face of these restrictions, both labor supply and demand suffered particularly in Costa Rica, Honduras, and El Salvador, which translated to reduced income for laborers, higher costs for the producers in a year of low selling prices, and even delays in the collection with the loss of volume and quality in the harvest.

This year, governments have relaxed COVID-19-related restrictions, even with surges of COVID-19 infections due to new variants, and a reintroduction of stringent restrictions is not expected. Additionally, the modification in the infrastructure and the knowledge gained from last years' experience will benefit the sector. Nonetheless, the outlook of decreased production in some countries and the existent challenges in movement and health status of those involved in the harvest will inevitably have an effect in income generation for households reliant on coffee production.

According to the USDA's forecast, there will be a regional deficit of 377 million 45-kg bags which would mean the loss of 15,834 jobs, and at least 16.86 million USD in wages, if we consider the minimum average daily wage of 7.10 USD recorded for Nicaragua in a survey carried out by Enveritas in 2020.

FOOD SECURITY IMPLICATIONS

Central America. The coffee sector is important for the livelihoods of nearly a quarter of the Central American population, including some of the poorest households, who rely on income from these daily wages to cover food and other basic needs. The net proceeds of this season will therefore have implications for the economy and food access of these households.

The series of shocks faced over the last decade have deteriorated the livelihoods of households reliant on coffee production. The ongoing pandemic and two hurricanes at the end of an above-average rainy season in 2020 posed unique challenges, with losses of private and public infrastructure, crops, and income. This forced households to take on additional debt and to utilize other negative coping strategies, including an increase in the number of people considering migration to the north or to the capitals or other urban areas.

In **Guatemala**, a modest increase in the production forecast for the upcoming coffee year will not offset the income losses from last year or support the recovery from past debts in the sector. Nonetheless, the number of day laborers needed for the harvest and the daily wage are expected to be within average ranges. This year, there are fewer restrictions related to COVID-19, which will lead to less constraints in terms of transportation, but the health protocols established last year are expected to be implemented again this year for field activities and accommodations. Laborers' households are expected to have average income, from which they will access food and other basic needs in the first months of 2022, although reported increases in food and fuel prices will likely reduce overall purchasing power.

In **El Salvador**, the 2021/2022 harvest is expected to see a slight increase, and the government has no restrictions in place, which will mean a modest improvement in the income generation for laborers as opportunities increase. Given the deterioration of this livelihood in recent years, however, this income will barely cover immediate needs. The gradual upturn in other employment options outside the coffee sector, such as domestic work and other informal types of work, and the wide delivery of food assistance from the government will support food access, although it is unlikely to enable any recovery of coffee-related livelihoods.

Some of the growers, on the other hand, will see a total loss of their income from this sector, as banks are seizing their farms and they have no way to pay off their debts to recover them. It is likely these households have resorted to a diversification in their income sources; nonetheless, the negative impact of these losses on affected households will be significant. Prolonged periods of crisis in the coffee sector limit the advances in its sustainability; additionally, these conditions have pushed households to more indiscriminate use of resources and a reduction in quality of life in an effort to offset the unfavorable economic results of the last years.

The coffee sector in **Honduras** is currently dealing with the aftermath of last year's hurricanes, with some losses and damages in crops and productive infrastructure. In addition, efforts are being made to contain an increase in the incidence in coffee rust to avoid further damages to the trees, which are already stressed by irregularities in rainfall in the beginning of the season. Despite households' need for income, Honduran producers have reported difficulty in hiring laborers in recent years, and this is expected to continue. Unfortunately, low labor supply does not necessarily result in higher wages for laborers, as coffee farm owners can often use unpaid or lower paid family labor to replace normal wage labor. Although there are still some movement restrictions in place, it is likely transportation and harvest activities will be carried out relatively normally, with the social distancing and equipment required to avoid COVID-19 contagions. Income from the coffee harvest is likely to be close to average or slightly below-average, which will still result in a relative improvement in household purchasing power compared to recent months, but not recover to pre-pandemic levels.

The scenario in **Nicaragua** is mixed, as the conditions in-country are similar to last year, since the government never imposed the mandatory COVID-19 restrictions, and the forecast is of a slight increase in production. For laborers who migrate to Costa Rica and Honduras, the situation has improved since 2020 as fewer restrictions in both countries will allow flows of migrant laborers to resume. Migrant labor in the region will, therefore, be closer to the pre-pandemic levels and wages are expected to be close to average. With access to a stable source of income during the harvest months, migrant laborers are likely to be able to save some portion of their income, which will later be used to purchase food during the annual lean season.