



# Hop Growers of Washington

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## **The U.S. Hop Market Background, Current Situation and Future Projections March 2008**

Hops are a specialty crop, commercially produced in Washington (74% of hop acreage), Oregon (17%) and Idaho (9%). Washington's hops are located in the Yakima Valley, between Moxee and Benton City. US acreage totaled 30,911 in 2007, with 22,745 in Washington. Oregon's hops are located in the Willamette Valley, primarily between Portland and Salem. Approximately half of Idaho's acreage is in the northern part of the state, near Bonner's Ferry, while the balance is located in the southern region (Boise-Parma area).

The hop industry is international, with nearly 70% of US production annually exported to more than 60 countries worldwide. Germany has similar statistics. Germany and the US are the two largest producers, supplying 60% of the world's hops. Both countries ship to many of the same customers, who use a blend of US and German hops. Hops are primarily sold on 3 to 5 year forward contracts, with prices and quantities "locked in" at the time the contract is issued. On the average, over 90% of the crop has been contracted in advance of harvest.

In the mid 1990s several new "super alpha" hop varieties were released, and were widely planted in the US and Europe. These new varieties yield as much as 50% more pounds per acre, compared to the high alpha varieties they replaced. In addition, alpha acid yields are in the range of 16% or more, instead of 14% for the old high alpha varieties. As a similar number of acres remained in production, but produced substantially higher yields of alpha, the market was rapidly flooded with alpha acid, driving prices to levels that were well below the cost of production. As a result, extensive acreage reductions were necessary both in the US and Europe. US growers removed approximately 30% of their acreage in the late 1990s to early 2000s. Prices remained low, but we were able to slowly work down the surplus, as we now had fewer acres in production worldwide than was necessary to meet the annual demand. The price for "spot" (uncontracted) hops was even lower than the contract prices, so growers (and their bankers) were very careful to only produce hops that were contracted.

As hop merchants tracked inventories vs. annual demand during the mid 2000s, they knew we would soon reach a point where the acreage and annual production needed to be increased to provide equilibrium with annual demand. We hit this point in 2005-06. As this situation approached, merchants started encouraging brewers to again lock in long-term contracts for their hopping needs (which was the norm before overproduction occurred in the mid to late 1990s). However, new purchasing staff at most of the major breweries and inexperienced purchasing staff at new craft breweries had never experienced a situation where they could not secure their hop supplies at reasonable prices without contracts (a situation that had been the case for nearly 15 years). Many brewers resisted the merchants' requests to lock in long-term contracts. This left the merchants with no contracts to offer growers, so acreage was not increased to meet the looming shortfall in supply to cover annual demand.

One must remember that the hop industry in the US had been producing a crop that, for the most part, had returned less than the cost of production for over a decade. Growers subsidized the crop by growing other commodities and by borrowing against land equity. The banking industry experienced substantial losses, and were unwilling to advance large sums for expansion of production infrastructure without knowing the growers had long-term contracts in hand that would allow repayment. For a grower to put in new acreage costs about \$6,000/acre for trellis and irrigation infrastructure, in addition to annual production costs. It is a large sum that must be amortized over the life of the yard, and bankers generally want to see it repaid over the life of the contract.

When the 2006 harvest was complete, our supply was barely adequate to cover the subsequent year's demand. We then lost a large Yakima hop warehouse to fire (September 2006), which destroyed a

portion of the 2006 crop. Merchants scrambled to cover their brewing customers in 2006-07 by purchasing back excess inventory from some of the breweries and spreading the available supply around to those who needed it. Some brewers recognized the situation and locked in contracts to cover their needs, which allowed some grower contracting and acreage expansion to occur in 2007 (about 2000 acres were planted last spring). However, greater expansion was not possible, as merchants were only able to offer contracts to growers that they were able to cover with contracts from the breweries.

However, the 2007 growing season proved difficult both in the US and Europe, due to weather and pest/disease related issues. Both the US and Germany had below-normal yields in some varieties in 2007, causing shortfalls. Prices reflected the tight supply in a market with strong demand. However, most growers were unable to benefit from the improved prices, as their entire production was locked into pre-existing contracts at substantially lower prices. The prices for the few uncontracted hops that were available skyrocketed, but there were simply not enough hops to cover the annual demand, and many breweries have gone without adequate supplies of the varieties they need for 2007-08 brewing.

As a result, brewers (large and small) have been rapidly contracting for future hop needs. This has resulted in many new contracts to growers for 2008 production. We anticipate 5,000-8,000 additional acres will be planted this spring. This will bring US hop acreage back up to between 36,000 and 39,000 acres (previous high was 44,000 acres in 1996).

Additional expansion is anticipated for 2009, but likely at a slower pace. Our industry has consolidated harvesting infrastructure over the past 15 years in response to decreased acreage and lack of profitability, and rebuilding this infrastructure will take time and much investment. Inadequate harvesting facilities, tight labor supplies and other constraints will prevent the industry from expanding much more than this for the next couple of years. There is an expectation that good prices will prevail for approximately 3 years, and will then return to levels near the cost of production as the annual production again comes into line with annual demand.

We hope to be able to better match our production capacity with annual demand, to avoid large surpluses and deficits in supply for future years. This will allow the price to moderate, hopefully at a level that will allow growers to earn a fair profit and brewers to secure their necessary ingredients at reasonable prices.

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