

## Food prices on the rise again, no major crisis in sight yet

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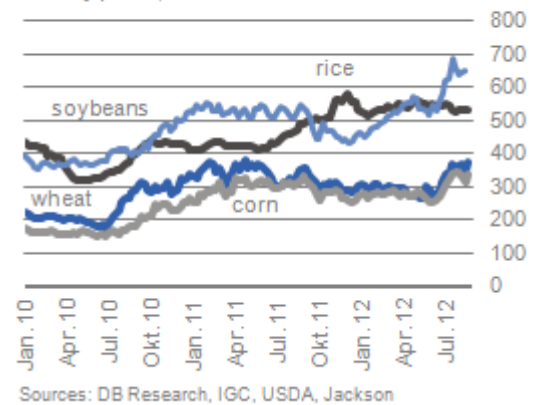
Corn, wheat and soybean prices skyrocketed in June-July although they have slightly decreased in the past few weeks. In July, the cereals price index of the FAO (Food and Agriculture Organization of the UN) went up 17% to reach 260 points, close to the record high of 274 points reached in spring 2008 (the peak in April 2011 was 265). The overall food price index climbed 6% in July to reach 213 points, still far from the peak of 238 reached in February 2011.

### Historical drought in the US and poor crops from the Black Sea

The rise in the food price index is mostly driven by increased grain prices. The acute drought affecting the US, the world's leading producer and exporter of cereals, has devastated corn and soybean harvests. This year's US corn crop is expected to be around 13% lower than last year's and the lowest since 1995 (at around 273 million tonnes, in contrast to the record high of 375 million tonnes previously expected for this year – due to the largest planted area on record since 1937). Soybean prices have also been soaring to record highs. High corn prices have driven wheat prices up, given that the latter can be used as a substitute for corn as animal feed. An additional factor is the drought in the Black Sea region which also threatens wheat production in Russia (second-largest wheat exporter after the US), Ukraine and Kazakhstan. Russia's wheat crop is now forecast at 41 million tonnes, 10% lower than previously expected and smaller than the crop following the last severe drought in 2010. Although there has been communication to the contrary, this may lead to export restrictions. Meat prices will eventually be driven up (by 5% according to the USDA) but this is not expected until next year since farmers are now forced to rush their cattle to market to avoid prohibitive costs in feeding them – thus boosting supply.

### Grain prices mostly high

Weekly prices, USD/tonne



### No major crisis yet

Although the situation is of concern and higher food bills are expected in the coming months, a widespread food crisis is not in sight at this point. A positive sign is that so far the price of rice has not been affected – although lack of precipitation may become a concern in India. Monsoon rain has been 14% short of average, which threatens cereal and pulses production in a country where 55% of farmland is not irrigated. Moreover, high crude oil prices have eased (they were sharply rising in 2007/08). Concerns about underlying inflation are also lower now, thanks to current global economic conditions. Demand is expected to decrease, both as a response to high prices and as a result of a slowing economy. The debate about biofuels is picking up: 40% of the US corn crop is used to produce ethanol rather than food or feed.

### More spikes to be expected in future

Food prices have been increasing in the past few years and spikes are more likely. Indeed, the supply/demand situation is tight and food stocks are low. Global stocks of corn and wheat may reach multi-year lows. Extreme weather events, particularly drought, are expected to increase in frequency, intensity and length of time. Price volatility will not go away easily.

### Some winners, poor people affected most

Some farmers may benefit from high food prices, for instance those corn farmers in the US who were not much affected by the drought (northern Corn Belt). Those whose crop was destroyed may not lose out much if they had insurance, especially if they bought an insurance plan allowing them to be paid for drought-destroyed crops at market prices. Livestock farmers will be affected by high feed prices.



Customers will be faced by higher food prices, even if large increases in commodity prices have a limited impact on final product prices. In developed countries, where more processed food is consumed, raw materials often amount to a small portion of the cost of processed foods, compared to labour, processing, transportation and distribution. Experience has shown that a 50% increase in commodity prices translates for retail food prices into a rise of a few percentage points.

In developing countries, the transmission from world shocks to domestic markets is often limited by price controls or managed trade environments and occurs with a time lag. However, the poor tend to spend a high share of their expenditure on food (62% for the poorest quintile in India, according to ADB vs an average of 10-15% in industrialised countries). Even farmers in developing countries often do not benefit from higher food prices since smallholders tend to be net food buyers. A proportional increase in prices for agricultural inputs also leads to higher costs which are challenging for them to manage.

Urban consumers are also affected. The food crisis of 2007/08 and 2010/11 led to social unrest, particularly in North Africa and the Middle East. It is too early to expect a repeat of these events but a global food price spike may prompt further political unrest in a region where new regimes are still trying to find their footing and old ones are trying to cling to power. Poor countries in general have been especially impacted by a slowing world economy, eurozone turmoil and higher unemployment. This is likely to limit their ability to deal with higher food import bills.

#### **A range of responses from governments, business, consumers**

Responses to a tense supply/demand situation include both readiness for emergency interventions and longer-term initiatives to boost agricultural production. Increasing productivity and market access for the 500 million smallholders worldwide - including partnering with agribusiness - remain key. Ensuring the sustainable use of water and land is also critical - using judicious incentives such as appropriate water pricing, payments for environmental services (including water and soil quality as well as biodiversity) and improved land tenure systems. Given that around one-third of food produced never reaches a plate (according to the FAO), reducing food loss is also part of the solution. Modifying diet preferences towards more sustainable consumption will also help.

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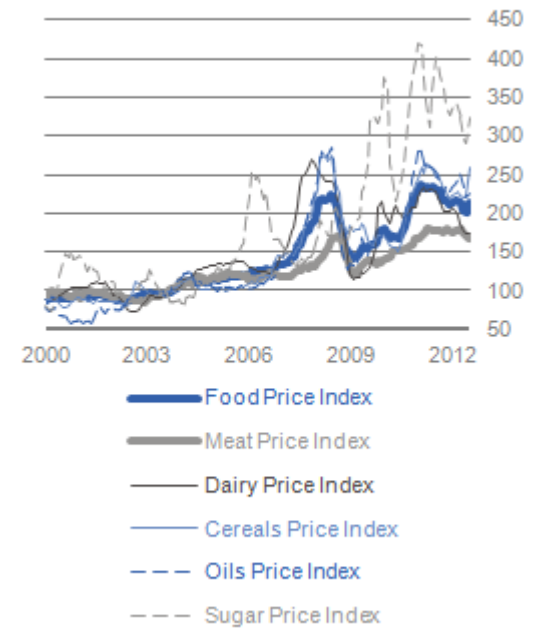
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### Food price indices

2002-2004=100



Sources: FAO, DB Research



Dr. Claire Schaffnit-Chatterjee (+49) 69 910-31821

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