

**FOOD PRICE TRENDS AMID THE GLOBAL
ECONOMIC SLOWDOWN**

**Compiled by
Economic Research Division**

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EXECUTIVE SUMMARY

Since 2006, global food prices started rising sharply mainly due to rising demand driven largely by increasing demand from increasing disposable incomes particularly in Asia. Changing climate conditions due to global warming also put constraints on agriculture production world wide, which resulted in tighter supplies amid growing demand and this, together with high input costs, also contributed to rising food prices.

This report aims to look at food price trends since the beginning of the global economic slowdown. Some of the key findings discussed in this report are:

- Global food price increases started slowing down during the economic downturn as consumers' disposable income decreased due to large scale global job losses.
- One of the hardest hit industries was the dairy industry as consumers moved from what was conceived to be "luxurious" food items to cheaper and essential food items.

With current positive prospects of a global economic recovery, food prices are expected to start rising again in the long-term, though in the short-term the demand for certain food items is expected to remain relatively low due to high unemployment rates and loss of income. The food insecurity situation is also expected to worsen as prices remain high in many developing countries as costs are high, especially in African countries, and the risk of future price volatility persists.

1. Introduction

Prior to the global economic downturn, global food prices increased sharply as global agriculture supplies failed to meet the significant increase in demand resulting from economic, climatic and demographic factors. Since the beginning of the global economic downturn in 2008, global food price increases have slowed down. The decline in food prices has resulted in farmers placing hectares out of plantation or production being suspended. However, prices remain high in many developing countries, as costs are high in Africa especially in Southern Africa, and the risk of future price volatility persists.

2. Background

Global food prices increased by 23.9% in 2008 compared to 2007 (FAO, 2009), which was considered too high when viewed from the perspective of previous price increases. The biggest price increase was encountered by cereals increasing by 42.6% in 2007 compared to 2008. The soaring oil price was a huge contributor to a rise in input costs increasing by 33.3% in 2008. The FAO food price index (Figure 1) shows a sharp upward trend in prices from 2007, as the prices of food items sky rocketed.

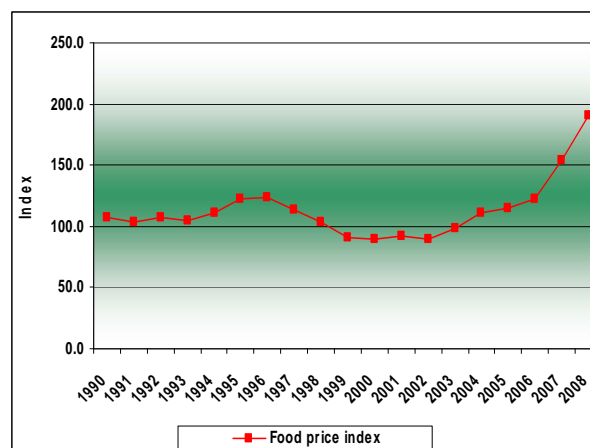


Figure 1: FAO Food Price Index

Source: FAO

Locally, food inflation has risen by 0.6% between September 2009 and October 2009 and the annual rate decreased to 5.3% in October 2009 (Stats SA, 2009; NAMC, 2009b). The biggest increase came from the fish and the vegetables industry. Vegetable prices increased by 16.6% year-on-year (y/y) in October 2009 and 5.6% month-on-month (m/m). Fruit prices also increased y/y by 13.9% and by 0.5% m/m, but it is normally assumed that fruits and vegetable prices stabilize quickly, unlike the price of cereals (Joshi, 2009).

Although prices at the retail level remained high, producer prices at the farm level continued to decrease. Prices received by farmers for agricultural products increased on average by 6.2%, while prices paid by farmers for farming requisites rose by 23.2%, resulting in the terms of trade weakening from 1.06 to 0.91 in June 2009 compared to June 2008. Fuel

prices showed an increase of 14.1%, while prices paid by farmers for fertilizers rose by 70.6 % in June 2009 compared to June 2008. Expenditure on farm feeds, fuel and fertilizers increased by 21.8%, 18.2% and 13.2%, respectively, in June 2009 compared to 2008. Expenditure on farm feeds remains the biggest expenditure item as depicted in Figure 2 below.

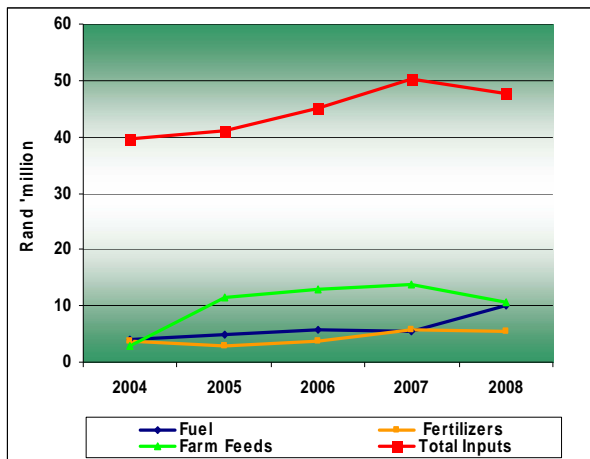


Figure 2: Agricultural expenditure
Source: DAFF

3. Food Production Outlook

With the new 2009/10 marketing season commencing, prospects continue to be positive, as world cereal production is expected to be the second largest ever, after last year's record (FAO, 2009). Respectively, world cereal production, wheat output, rice output and sugar production are expected to be 3%; 4.2%; 9% and 5.4% lower than last year. Meat, milk and oil-seed output are expected to be 1.2%; 1.6% and 0.7% higher than last year, respectively. Locally, the expected area

planted to maize for the 2009/10 season is estimated to be 6% ha more than last season. In the case of sunflower seed and sorghum, the expected planting is expected to decrease by 28.8% and 18.1% respectively, compared to the previous season. Plantings of soybeans, groundnuts and dry beans show increases of 14.0%, 16.4% and 0.5% respectively. The production forecast for wheat in 2009 is expected to be 6.2% lower than last year, after farmers put hectares out of production due to uncompetitive prices in the local and international markets, as well as due to high input costs. Already industry officials have applied for a tariff to help revive the industry's competitiveness. Canola crop is expected to be 48.2% higher than 2008, and for malting barley 14.9%.

Weather: El Niño/Southern Oscillation (ENSO) forecasts continue to show enhanced probabilities of El Niño conditions to occur in SA during the 2009/10 summer rainfall season, and that the anticipated El Niño event may be moderately strong. However, the intensity of an El Niño event does not indicate how much the event may affect Southern African rainfall during the summer months. For the remainder of the summer season until April 2010, below normal rainfall seems to be favoured over most parts of the country except provinces in the north east (Limpopo and Mpumalanga) where the probability of above

normal rainfall ranges between 40-50%, this includes the South-western Cape coast (National Agro Meteorological Committee (NAC), 2009).

4. Food Price Trends

Domestic inflation figures show that the SA food price index started rising in 2006, and began its sharp decline in January 2008 before doubling again in November and December 2008, as demand increased during the festive season. Figure 3 below shows that the food price index in 2008 was below the 2007 levels but this can be attributed to, inter-alia, Stats SA's new measure of inflation.

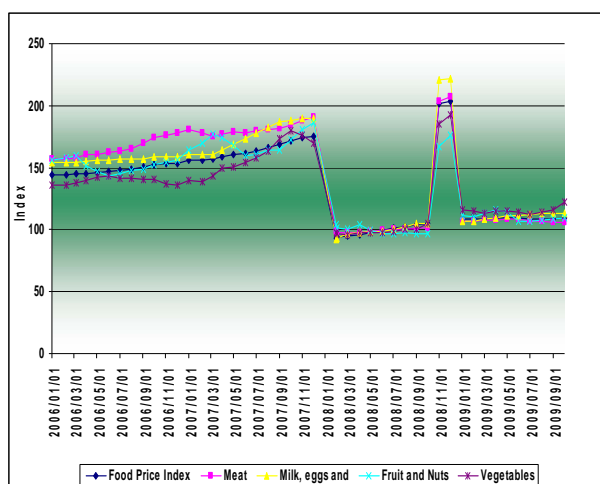


Fig. 3: SA Food Inflation Trends

Source: Stats SA

Comparing 2009 and 2008 under the new measure, data shows that the food price index is still higher in 2009 than it was in 2008, although it is starting to stabilize, but prices of various commodities are still resistant. According to the National Agri-

cultural Marketing Council (NAMC)'s Food Price Monitor (February 2009) (NAMC, 2009a), fresh meat prices increased, on average, by 7.9 % between January 2008 and January 2009. Between July 2008 and January 2009, fresh vegetables experienced price increases of 83.9% while fresh meat prices increased, on average, by 7.9 % between January 2008 and January 2009. High costs of food and fuel as well as electricity hikes, shortages and high distribution costs; are among some of the factors to be blamed for the lag in South Africa's food price declines at the retail level, although at farm level prices are declining in relation to international prices. SA food prices remain high in comparison to declining international prices as the global financial crisis intensified. However, as depicted in Figure 3, all essential commodity prices started bottoming out from January 2009, although the prices were still high compared to 2008.

International prices of most agricultural commodities have fallen in 2009 from their 2008 highs, the FAO project a 29.1% food price decline in 2009 compared to 2008. As depicted in Figure 4, the meat price index has increased by 0.4% m/m in October 2009, while y/y the price has declined by 11%. During 2008, the price of meat increased by 14.5% compared to 2007, however, the international meat price is

projected to decline by 8.3% in 2009 compared to 2008 (FAO, 2009). Fish and meat prices are taking a setback from faltering demands, in the wake of slowing economies and recurring animal diseases.

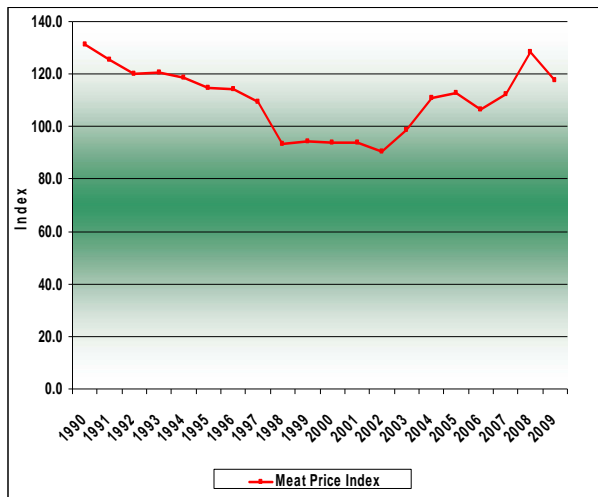


Figure 4: Meat Price Index
Source: FAO

International dairy prices seem to have taken a huge knock as depicted by a sharp decline in the dairy price index for 2009 shown in Figure 5.

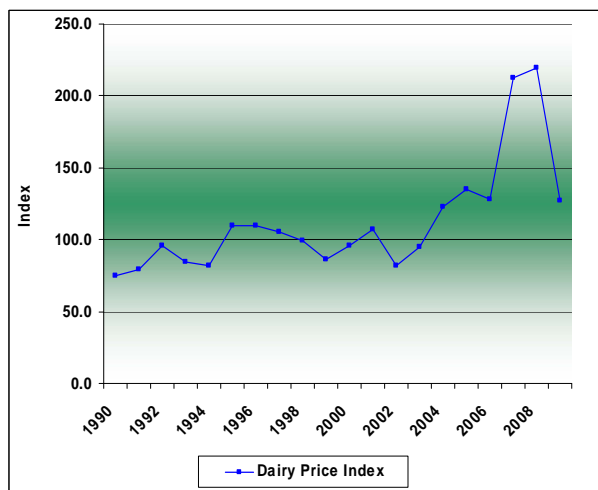


Figure 5: Dairy Price Index
Source: FAO

Indications are that dairy prices are rebounding after the price squeeze earlier

during the year due to the economic recession. Locally, milk, eggs and cheese are driving up dairy prices, increasing by 0.2% in October 2009 compared to September 2009 (Statistics, 2009). The FAO estimates that dairy prices will decline by approximately 41.9% in 2009 compared to 2008. Faltering demand has resulted in a price squeeze that began late last year resulting in most governments supporting struggling dairy farmers (USDA, 2009).

The cereals international price index showed an upward trend which began in 2008 as depicted on Figure 6, driven, inter-alia, by biofuel production.

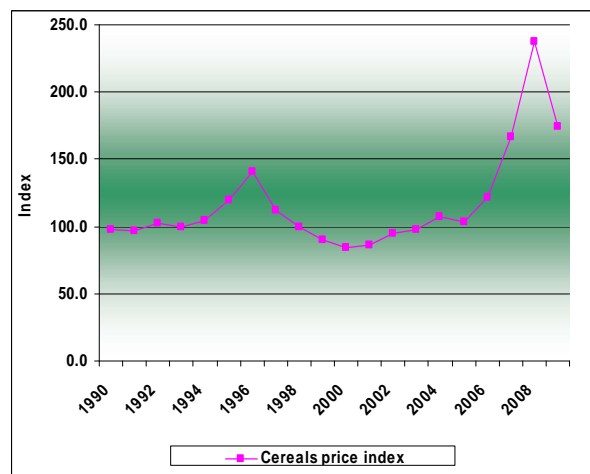


Figure 6: Cereal Price Index
Source: FAO

The FAO cereals price index increased by 4.8% m/m in October 2009 while y/y the price decreased by 13.2%. Locally, bread and cereal prices decreased by 0.4% m/m in September 2009. The cereal price index is projected to decline by 26.8% in 2009

compared to 2008 mainly due to better crop prospects expected globally. There has been a significant decline in prices of grains globally due to the global recession. As shown in Table 1, domestic prices of grains were higher in 2008 compared to 2009.

Table 1: Price of maize and wheat per ton

| | End Oct 2008 | End Oct 2009 |
|--------------------|--------------|--------------|
| White Maize price | R1807 | R1 475 |
| Yellow Maize price | R1785 | R1 384 |
| Wheat price | R2 888 | R2 160 |
| Sunflower price | R4 180 | R2 890 |
| Soya price | R3 740 | R2 830 |

Source: SAFEX

In the year ending October 2009 compared to October 2008, the local price of white and yellow maize declined by 18.4% and 22.5%, respectively, while the price of wheat, sunflower and soya declined by 25.2%, 30.9% and 24.3% respectively.

5. Global and Local Events that may Affect Food prices:

The global economy appears to be expanding again, pulled up by the strong performance of Asian economies and stabilization returning in other economies. The pace of recovery remains slow and is expected to further worsen the food insecurity situation through **unemployment** and **loss of income**. Employment in SA

decreased significantly by 3.6% between Q2:2009 and Q3:2009. A total of 484 000 jobs were lost between the two quarters, with most job losses recorded in the formal sector (283 000), followed by the informal sector (116 000). The OECD-wide unemployment rate shows that in September 2009, there were 15.7 million more unemployed people in the OECD area compared to the end of 2007. It is projected by OECD that unemployed people in OECD countries will be almost 21 million higher than at the end of 2007. Unemployment is projected to continue to rise until the end of next year, but at a diminishing pace. The jobless rate is expected to peak in the first half of 2010 in the US, but it may not be until 2011 that unemployment begins to fall in the Euro area.

Locally, **consumption** by households continues to decline after contracting by 5.8% in the second quarter of 2009, from the 4.8% drop in the 1st quarter 2009 (Reserve Bank, 2009). The recovery is slow because businesses and households are still using the low interest rates to repair their finances and to reduce their debts.

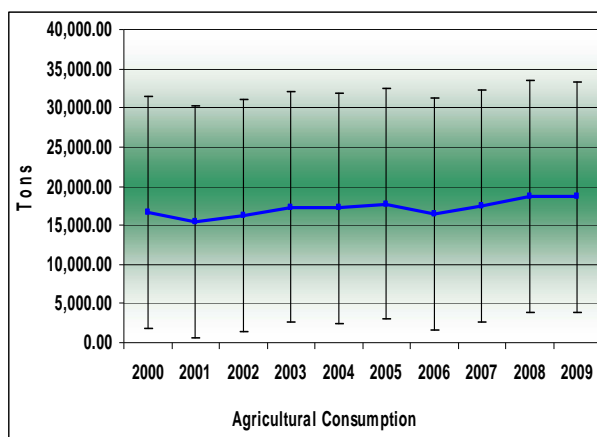


Figure 7: Agricultural Consumption

Source: Agricultural Statistics

Consumption of agricultural products has been variable over the years (Figure 7). Local consumption of agricultural products is expected to decline by 0.7% in 2009 compared to 2008. Consumption of maize is expected to decline by 1.4%, sorghum 11.5%, fruits (deciduous) 0.1% and Citrus 43.6% while the consumption of beef, mutton and eggs is expected to decline by 3.5%; 17.3% and 4.8% respectively.

There was a sharp increase in oil prices that began in 2006 as depicted on figure 5, due to global oil supply and demand imbalances. World **oil demand** is forecast to grow by 0.8 million barrels/per day (mb/d) in 2010 following a 1.4 mb/d contraction in 2009, although the potential weak economic recovery may dampen potential demand growth in the coming year (OECD, 2009).

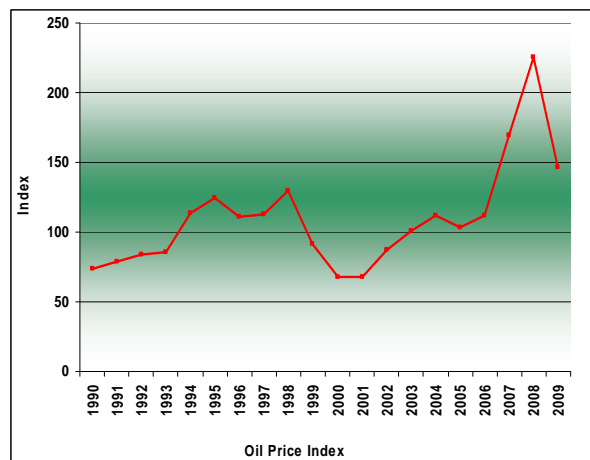


Figure 8: Oil Price Index

Source: FAO

For 2009, the oil price is projected to be 34,9% lower than last year, with price averaging \$146.8 from \$225.4 in 2008. Locally, the transport index decreased by 1.0% in October 2009, mainly due to a 39c/l decrease in the petrol price. The **oil price** has a bearing on agricultural production through fertilizers, operating farm machinery and equipments as well as for transportation purposes. The fertilizer-to-crop price ratio is a key factor in determining the behavior of farmers when purchasing fertilizers. According to International fertilizer Association (IFA), 2009, most fertilizer demand is expected to increase in Asia and to a lesser extent Latin America.

6. Conclusion

Prices rise when markets get tight and the reasons may be temporary or permanent. The most common advice coming from related industry officials is for farmers to diversify when prices are not competitive.

It is expected by the OECD-FAO Agricultural Outlook, 2009, that once economies recover, a strong combination of supply response and continued growth in demand is expected to keep prices above historical levels, but well below the peaks experienced in 2008. Macroeconomic conditions that favour economic growth, increases in purchasing power, and stronger demand for agricultural commodities are expected to continue, at least for many countries. The fundamentals like climatic changes will also continue to have an effect on prices. Demand for food is expected to rebound after the economic recovery, surpassing previous years' levels as income and population continue to grow.

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