Crop Prices Soar, Pushing Up Cost Of Food Globally New Demand for Biofuels Feeds Inflation Pressure; China, India Feel Pinch”, By PATRICK BARTA, April 9, 2007; Page A1

Soaring prices for farm goods, driven in part by demand for crop-based fuels, are pushing up the price of food world-wide and unleashing a new source of inflationary pressure.

The rise in food prices is already causing distress among consumers in some parts of the world -- especially relatively poor nations like India and China. If the trend gathers momentum, it could contribute to slower global growth by forcing consumers to spend less on other items or spurring central banks to fight inflation by raising interest rates.

Politicians in markets where food costs are a particularly sensitive matter are moving to counter rising prices before they take a bigger economic toll or fuel unrest. But it remains unclear whether those policies will be enough to contain the current pressures, or whether a longer-term bout of food-price inflation -- similar in ways to the recent climb in prices for oil and other commodities -- is in the offing.

One of the chief causes of food-price inflation is new demand for ethanol and biodiesel, which can be made from corn, palm oil, sugar and other crops. That demand has driven up the price of those commodities, leading to higher costs for producers of everything from beef to eggs to soft drinks. In some cases, producers are passing the costs along to consumers. Several years of global economic growth -- led by China and India -- is also raising food consumption, further fanning the inflationary pressures.

Food-price inflation has been climbing -- in some cases sharply -- in India, China, Europe, and even smaller economies like Turkey, South Africa and Poland. In Hungary, it is running at more than 13% a year, compared with less than 3% in 2005. In China, food prices are climbing at a 6% pace, more than three times the speed of a year ago. Prices are also up in Germany, Italy and the United Kingdom. They may even be picking up in Japan, the world's second-largest national economy, though the signs are tentative since overall prices there are only just starting to rise after a prolonged economic downturn.

The U.S., too, is seeing some stirrings, with food costs rising 3.1% in February from the year before -- a rate one percentage point higher than in mid-2005. Economists say U.S. food prices are expected to rise faster than the general rate of inflation this year. Wholesale prices of meat, poultry and eggs have already increased.

If the trend continues, U.S. consumers are likely to see higher prices at the supermarket for everything from milk to cereal to soda pop, since corn is used to feed livestock and make high-fructose corn syrup, a key ingredient in many soft drinks. A spokesman for the National Chicken Council, a poultry-industry group, recently testified to a congressional subcommittee that Americans should expect higher chicken prices because of what the group described as "the ethanol crisis."

Doomsday predictions of a major food shortage in China and elsewhere have circulated for years but haven't materialized. And some economists believe the recent increase in crop demand probably can be met without severely straining the global economy. They think prices could come back down over time, especially if some countries that have more land that could be put under cultivation -- particularly Brazil -- can greatly increase production. Technological advances, such as better seed varieties, could also help boost production to keep up with demand.

In the meantime, higher farm prices aren't bad for everyone. They could help boost incomes for the rural poor in developing nations, who have been bypassed by gains in the manufacturing and service sectors. In some cases, the rising demand for food also reflects the growing wealth of once-destitute populations around the globe.

So far, higher prices haven't sparked a major rise in overall global inflation, which remains relatively low and stable by historical standards. Moreover, food prices are notoriously volatile, and some of the increases are due to short-term or local factors that could reverse in time.
But many economists believe the forces causing the current bout of food inflation will persist, or recur in years ahead. Many countries are facing shortages of land and water that didn't exist during past food-price spikes, so they can't easily plant more to ease the strain.

Researchers at Swiss bank UBS AG note that average food prices in China have grown faster in the past five years than in the previous five, as more agricultural land is taken up for factories or high-rise condominiums. Changes in diets are also exacerbating the problem, as rising incomes allow the Chinese and consumers in many other places to eat more.

Some economists contend that China and India appear to be reaching a point at which nothing short of a bumper crop of key commodities will be enough to meet local needs and prevent further surges in food prices. In fact, China and India have achieved historically high production of some crops in recent years, only to see prices continue to climb.

Global grain stocks are at their lowest level in 30 years, after several years of strong global economic growth, and could become even tighter if farmers divert more crops to make ethanol or other fuels. By some estimates, about 30% of the U.S. grain harvest is likely to be devoted to ethanol production by 2008, up from 16% in 2006.

All of this puts the world's central banks in a bind. Although they have confronted spurts in energy prices, many of them haven't had to cope with prolonged increases in food prices since the 1970s. Since then, food-price inflation has remained relatively benign, even as incomes world-wide have climbed, allowing consumers to beef up their diets.

In more recent years, central banks have tried to ignore surges in food prices as long as they didn't get too out of hand, mostly because they tended to be short-lived. A change in weather, for example, could quickly turn a food shortage into a glut, sending prices tumbling.

But a more sustained bout of food-price inflation, if it emerges, could force banks to keep interest rates higher than they would otherwise be. India, for one, has increased interest rates several times over the past year in part to combat food-price inflation.

"In 1972, the last time grain stocks were this low, the story didn't end well in terms of inflation," says Carl Weinberg, chief economist at High Frequency Economics in Valhalla, N.Y. In those days, inflation soared not just because of higher oil costs but also because of a global jump in food costs, all of which helped trigger a major U.S. recession and a global slowdown. "Food prices were an important part of what started [inflation] rolling" in the 1970s, Mr. Weinberg says.

But since the 1970s, the Federal Reserve and some other central banks have come to believe that they can avoid raising interest rates in the face of transitory increases in food and energy prices if they have established enough credibility as inflation fighters to keep such price increases from spilling over to the rest of the economy.

Today, the inflation risks may be greatest in developing economies. In the Philippines, food accounts for 50% of the basket of goods included in the consumer-price index, an inflation benchmark. In Thailand, it's about 35%, according to data from Macquarie Bank Ltd. In the U.S., food makes up only about 15% of the CPI.

In one bustling open-air market in downtown Shanghai, shoppers say they are paying as much as two times the price they paid last year for green vegetables, and the cost of meat and vegetable oils have also soared.

Such blows to the pocketbook "give us more pressure for daily life," says Xu Wen, a 53-year-old retiree who was purchasing some rolled noodles in a small shop last week. Already, she says, she and her husband are spending almost half their monthly income on food -- a percentage that continues to increase over time. "We ordinary people have no way out," she says. "This is something the government needs to be concerned about."

Government officials are taking pains to show they are addressing the problem. In December, Chinese Premier Wen Jiabao toured a Beijing supermarket to check up on prices, and China has begun limiting the construction of corn-based ethanol plants to ensure there is enough corn for humans and livestock. Chinese officials have even banned new golf courses on farm land and have been unwinding subsidies they once paid to grain distributors to sell excess corn overseas.

Still, analysts estimate Chinese stockpiles of surplus corn now stand at only about 30 million metric tons, down from more than 100 million tons at the end of the past decade, as demand picks up. (The Chinese government doesn't provide official estimates of its stockpiles).
That would imply that China only has two to three months of surplus supply based on current consumption trends, making the country highly vulnerable if it has a bad crop. Although China remains a net exporter of corn now, analysts believe it will become a net importer sometime in the next few years.

Some economists say China will have to take more aggressive steps to prevent future food problems. These changes could include allowing the proliferation of large -- but more efficient -- corporate farms similar to the ones that drove many small growers out of business in the U.S. in recent decades. Such a push would be extremely difficult for China because it needs to preserve jobs for the tens of millions of people who live in rural areas.

Pressures are also building in India. Monika Katyal, a 32-year-old homemaker, complains that she has had to cut back on purchases of many luxuries, such as cosmetics, as her family's monthly bill for groceries has climbed as much as 50% in recent months.

"I came here to do some shopping for myself, but now it doesn't look like I will be able to do that," she said recently, as she studied the price on a bottle of ketchup in a New Delhi grocery.

In addition to raising interest rates, Indian officials have also lifted import duties on corn and barred exports of wheat, to make sure supplies are available for domestic consumption.

But it isn't clear whether those and other moves will be enough to make a big difference in the long run. The main problem is that yields of some crops aren't growing fast enough to keep up with India's rapidly increasing food demand. India's corn production, for example, has climbed about 4% a year since 2001, says Amit Sachdev, a New Delhi-area agriculture-industry analyst, while demand has been increasing nearly 5.5% a year.

"If I look at the trend line, [it] indicates to me that the requirements are going up much faster than what you can produce" in India, he says.

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