Box 4

EURO AREA FOOD PRICES: RECENT DEVELOPMENTS AND OUTLOOK

The prices of several agricultural commodities, such as cereals and oilseeds, have increased significantly in world markets in the past few months.[1] In part, these price increases reflect temporary factors affecting the global supply of these commodities, such as adverse weather conditions in some major agricultural commodity-exporting countries. Global food prices have also been bolstered by the strong increases in the global demand for foodstuff resulting from the changes in food consumption patterns in many developing economies and from the emergence of new sources of demand for some agricultural commodities, for example for the production of biofuels. As these latter developments are of a structural nature, they are likely to have a more persistent upward impact on global food prices in the future.

The rise in global food prices has already led to notable increases in food prices in the euro area, at both the producer and the consumer level. The producer prices of food products and beverages rose by 7.5% in annual terms in October, compared with a rate of 2.2% on average in 2006. At the consumer level, the annual rate of change in HICP processed food excluding tobacco rose to 4.0% in October, up from 1.6% in 2006 (see Table A). By contrast, unprocessed food prices, which are traditionally more volatile, seem to have been less affected by the recent developments in global food prices so far.

The impact of global food prices on consumer prices in the euro area is also evident from a detailed breakdown of prices by product and category. For example, within the HICP processed food component, the prices of bread and cereals as well as of milk, cheese and eggs rose

1 For more information, see the box entitled "Recent food price developments in world markets and the euro area" in the September 2007 issue of the Monthly Bulletin.

Table A Unprocessed and processed food components of the euro area HICP

(annual percentage changes, unless otherwise indicated)

	HICP Weights (%)									
	2007	2004	2005	2006	2007					
					May	June	July	Aug.	Sep.	Oct.
Food	**19.6**	**2.3**	**1.6**	**2.4**	**2.4**	**2.4**	**2.3**	**2.5**	**2.7**	**3.5**
Unprocessed food	**7.6**	**0.6**	**0.8**	**2.8**	**3.1**	**3.0**	**2.8**	**2.4**	**2.1**	**3.1**
Meat	3.8	1.5	1.3	2.4	2.9	2.5	2.1	2.1	2.2	2.7
Fish	1.2	0.8	1.6	3.7	3.0	2.4	2.8	2.4	2.1	2.2
Fruit	1.2	0.7	-0.5	1.0	2.2	5.6	3.3	4.2	4.6	5.1
Vegetables	1.5	-1.7	0.1	4.3	4.0	2.2	3.9	1.8	-0.3	3.3
Processed food excluding tobacco	**9.4**	**1.3**	**0.5**	**1.6**	**1.1**	**1.3**	**1.3**	**1.8**	**2.6**	**4.0**
Bread and cereals	2.5	2.2	0.8	1.4	2.4	2.4	2.5	2.8	3.8	5.4
Milk, cheese and eggs	2.1	0.8	-0.1	0.6	0.7	1.1	1.3	2.2	3.9	7.6
Oil and fats	0.6	3.9	2.2	9.9	-5.1	-5.4	-5.2	-1.2	0.0	1.2
Sugar, jam, honey, chocolate and confectionery	1.0	1.6	0.0	0.9	1.0	0.9	0.9	0.9	1.1	1.5
Food products not elsewhere classified	0.4	0.5	0.0	0.9	0.5	0.7	0.6	0.6	0.5	0.7
Tobacco	**2.5**	**12.2**	**7.8**	**3.9**	**4.9**	**4.8**	**4.3**	**5.2**	**5.2**	**3.1**

Sources: Eurostat and ECB calculations
Note: The processed food aggregate also includes mineral waters, soft drinks, fruit and vegetable juices, spirits, wine and beer, which are not reported in this table.

Table B HICP processed food excluding tobacco across euro area countries

(annual percentage changes)

	2004	2005	2006	2007	
				May	Oct.
Belgium	1.6	2.0	1.9	3.2	5.0
Germany	0.3	0.2	1.0	1.6	5.2
Ireland	0.5	0.0	0.2	0.1	3.7
Greece	4.7	3.2	4.7	0.9	3.7
Spain	3.9	2.8	4.4	0.9	6.8
France	1.3	-0.6	0.7	0.1	1.3
Italy	2.2	0.6	1.9	1.8	3.5
Luxembourg	2.0	1.7	1.8	1.8	4.0
The Netherlands	-3.7	-1.8	0.2	0.3	2.8
Austria	2.3	0.8	1.5	2.5	6.5
Portugal	2.4	-0.8	1.7	0.5	3.8
Slovenia	0.8	-1.3	1.4	2.6	11.2
Finland	-4.0	-0.8	0.9	0.5	1.1
Euro area	1.3	0.5	1.6	1.1	4.0

Sources: Eurostat and ECB calculations

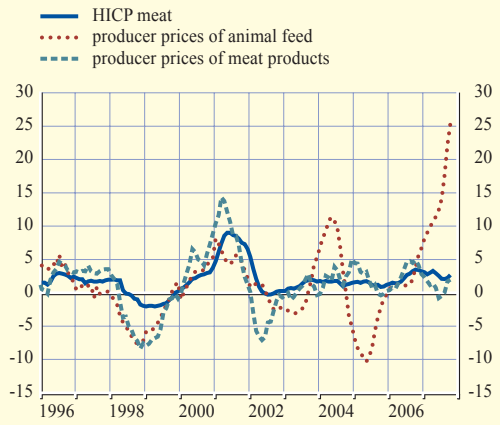
particularly sharply in October (see Table A). These items have a combined weight of around half of the total processed food component excluding tobacco. Anecdotal evidence suggests that the recent price increases in dairy products may also reflect the specificities of the formation of milk prices in some European countries, in addition to the price increases in global markets of animal feed and other input costs.

Although food prices at the producer and the consumer level have risen in all euro area countries in recent months, the extent to which the global food price shock has been transmitted to individual euro area countries has varied significantly. For example, the annual rate of increase of HICP processed food excluding tobacco was slightly above 11% in Slovenia in October, the highest rate within the euro area. In the same month, Belgium, Germany, Spain and Austria also saw sharp annual price increases in this component of between 5% and 7% (see Table B). By contrast, inflation for processed food excluding tobacco in France and Finland was significantly below the euro area average.

A number of factors are behind the diverse food price developments across countries. Retail food markets are traditionally segmented across countries. In this respect, differences in market structures and competitive conditions in the retail and distribution sectors are likely to explain the diverse reaction of retailers' profit margins across countries to a common external shock and therefore account for most of the difference seen in consumer food price inflation across countries. In countries where food price increases have been relatively contained, it appears that, in the context of high competition among retailers, profit margins may have acted as a buffer cushioning the steep increases in global food prices. Moreover, if the underlying economic conditions in a certain country are perceived to be weak, retailers may be reluctant to fully pass on high increases in food prices. Additionally, fixed periods for the negotiation of prices between suppliers and retailers may have also delayed the pass-through in some countries. By contrast, in countries where food price increases have been more considerable, it seems that retailers' profit margins have not acted as a buffer. In some cases, this might be due to the fact that food retailers operate in an environment of compressed margins. Under these conditions, input price shocks tend to be passed on to consumers more quickly. In some other countries, a

Chart A Prices for animal feed and meat in the euro area

(annual percentage changes)



Source: Eurostat.

Chart B Selling price expectations and producer prices of food and beverages

(percentage balance; annual percentage changes)

Sources: European Commission Business and Consumer Surveys and Eurostat.

lack of competition in some food market segments, in a context of robust underlying economic activity, may have also resulted in a quick and, in some cases, stronger pass-through to consumers.

Looking ahead, HICP food price inflation may increase somewhat further in the very near term as the past increases in producer costs are passed through to retail prices. Preliminary November data suggest that this is the case. Barring further shocks in food commodity prices, HICP food price inflation should subsequently fall back towards levels more consistent with its historical average. This outlook is in line with the information from futures contracts in global markets for food-related commodities. The balance of risks is on the upside. Meat prices, which represent around 50% of the unprocessed food component and which have been fairly muted so far, could be affected by the recent strong increases in the producer prices of animal feed (see Chart A). Moreover, the recent upsurge in the selling price expectations of producers of food, beverages and tobacco, as reported by the European Commission's Business Survey, signals further upward pressures on food prices in the near term (see Chart B).

Further ahead, the outlook for both world and domestic food prices remains highly uncertain. Although the supply of agricultural products should eventually respond to the increase in demand, the catch-up period may be more prolonged than currently envisaged. Moreover, food price developments depend on a number of factors which are difficult to predict, including technology advances and possible changes in energy policy. Hence, risks in the medium term also seem to be on the upside.