

Box 6

RECENT DEVELOPMENTS IN FOOD COMMODITY PRICES AND THEIR IMPLICATIONS FOR CONSUMER FOOD PRICES IN THE EURO AREA

International food commodity prices have increased sharply during the summer of 2012, pushing overall commodity price indices to higher levels than during the price spike of 2007-08. This box discusses the nature of the recent increases and their possible implications for consumer food prices in the euro area.

The nature of the recent surges in international food commodity prices

Composite indices of international food commodity prices have increased by more than 20% in US dollar terms since early June this year (see Chart A). In particular, the prices of soybeans, wheat and maize have all increased by more than 25% – and in the case of soybeans and maize they are currently at a historical high. These developments have raised concerns about a repeat of the food commodity price spikes of 2007-08, when food prices went up by more than 70% between July 2007 and July 2008.

The surge in commodity prices during the summer of 2012 has been the consequence of the worst drought in the United States in half a century and, according to the US Department of Agriculture, has resulted in substantial downward revisions to expectations regarding the supply of corn, wheat and soybeans. In the case of wheat, production also fell in the Black Sea region owing to a long spell of hot weather.

The recent spike in food commodity prices is different to that in 2007-08, however. In 2007-08 it came together with spikes across a broad set of commodities, including most staple food products, metals and oil, which were due primarily to the increase in demand for commodities from emerging market economies on the back of buoyant output and income developments. Furthermore, the impact of this on commodity prices was compounded by global supply disruptions. By contrast, the recent spike in commodity prices is concentrated on soybeans and selected cereals, and is mainly the result of specific regional supply shocks.

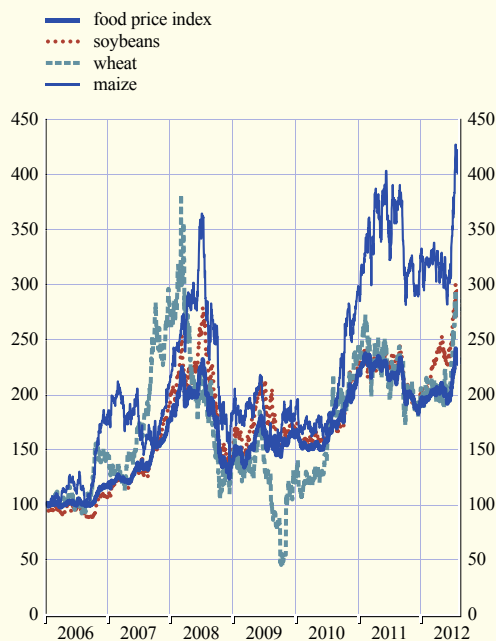
Given the regional nature of the recent supply disruptions, food commodity prices may remain high until the next harvest in the southern hemisphere, but are expected to fall again thereafter. However, should there be further downward revisions to supply estimates in the affected regions or new supply disruptions in other regions, world market prices may increase further.

Possible implications for consumer food prices in the euro area

Movements in international food commodity prices are not always directly relevant for consumer food prices in the euro area. In particular, the farm gate prices determined in the context of the EU's Common Agricultural Policy typically have a stronger bearing on consumer food prices than international commodity prices.¹ Against this background, Chart B shows that the indices of EU internal market prices and international prices for food commodities have co-moved

Chart A Developments in international food commodity prices

(USD; index: 1 January 2006 = 100; daily data)



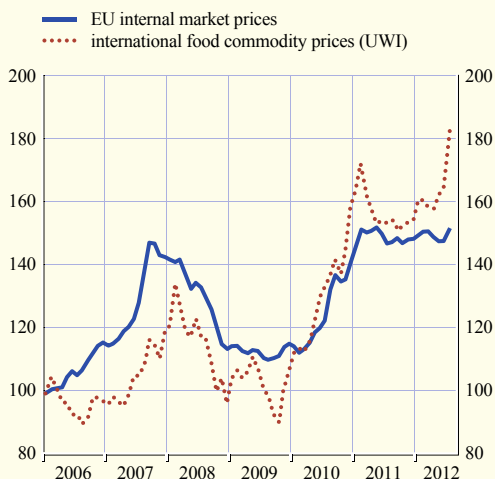
Sources: Bloomberg and HWWI.

Note: The food price index includes cereals, oilseeds, oils, beverages, sugar and tobacco.

¹ See Ferrucci, G., Jiménez-Rodríguez, R. and Onorante, L., "Food price pass-through in the euro area – the role of asymmetries and non-linearities", *Working Paper Series*, No 1168, ECB, Frankfurt am Main, April 2010.

Chart B Developments in EU internal market prices and international prices for food commodities

(EUR; index: January 2006 = 100; non-seasonally adjusted)

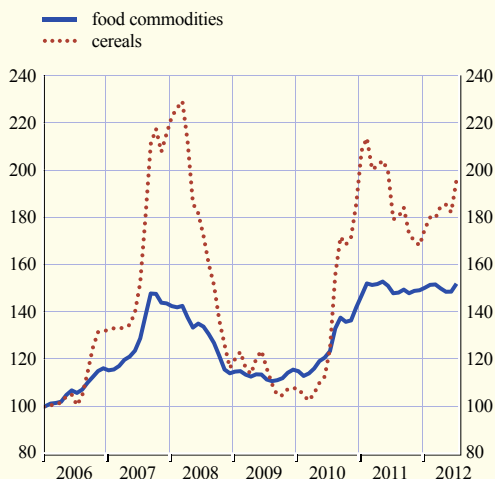


Sources: European Commission, Bloomberg, Datastream and ECB calculations.

Notes: The latest observation is for July 2012. The index for EU internal market prices covers cereal, meat, oil and dairy products. The ECB's use-weighted non-energy commodity price index (UWI) also covers some seeds, fruit, beverages, sugar and tobacco, but no dairy products.

Chart C Developments in EU internal market prices for food commodities and cereals

(EUR; index: January 2006 = 100; non-seasonally adjusted)



Sources: European Commission and ECB calculations.

Notes: The latest observation is for July 2012. The index for EU internal market prices covers cereal, meat, oil and dairy products. The cereals aggregate is a consumption-weighted average of malt barley, durum wheat, as well as rye, oats and wheat in the form of flour.

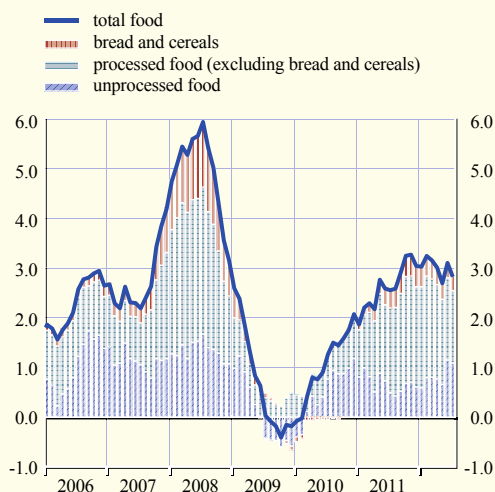
somewhat over the last few years, but that, on balance, EU internal market prices have varied less strongly. This is also true for the most recent developments. EU internal market prices for food commodities rose by 2.3% month on month in July 2012, thus clearly picking up after declining or stagnating for four consecutive months, but as yet have increased by significantly less than the 9.5% recorded for international food commodity prices in that month.

The main driver of the latest increase in overall EU internal market prices was the cereals component, which rose by 7.5% month on month in July (see Chart C). However, this increase was much smaller than the 26% hike in prices for grains on international markets.

Historically, there is a relatively strong pass-through of developments in EU internal market prices to euro area HICP food inflation – at least compared with that of other commodity prices. Chart D shows the strong contribution from the bread and cereals component to HICP food inflation in 2007-08,

Chart D Contributions to HICP food inflation

(annual percentage changes; percentage points; non-seasonally adjusted)



Source: Eurostat.

Note: The latest observation is for July 2012.

which was larger than would have been expected purely on the basis of its weight in the HICP and the developments in EU internal market prices for the underlying commodities. However, the degree of pass-through tends to depend on the specific macroeconomic environment at the time. During the period 2010-11 the doubling of EU internal market prices for cereals did not seem to have such a significant impact on the corresponding consumer prices, as was the case with the 2007-08 price spike, as it took place in a less favourable macroeconomic environment. In this respect, any further hike in EU internal market prices for cereals may also only have a more limited upward impact on HICP food inflation in the current environment.

Conclusions

The recent surges in international food commodity prices are expected to have a limited impact on consumer food prices in the euro area for two main reasons. First, compared with the spike in commodity prices in 2007-08, the recent increases are considered to be due mainly to regional and temporary supply-side effects (i.e. bad weather conditions in some regions of the northern hemisphere) on the prices of grains and oilseeds, rather than to global and persistent supply and demand factors impacting on the whole range of food commodity prices. Second, EU internal market prices, which tend to be a more relevant determinant of euro area food consumer prices than international commodity prices, have thus far shown much less upward movement. Against this background, euro area consumer food prices (in particular prices for processed food) are expected to continue diminishing over the next few months from the elevated levels seen at the end of 2011.