Food price declines

By Stafford Thomas

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From a crippling 16% a year ago, food price inflation had receded to a far more palatable 1.6% by January, its third lowest level in 35 years. Hard-pressed consumers can rest easy that food prices are unlikely to resume their climb soon.

With food leaving manufacturers' gates in January at prices 1.8% lower than 12 months earlier, consumers could be excused for expecting prices to drop further. And with prices at the farm gate slumping by 18.7% in January — the biggest monthly fall since 1975 — there should be hope for relief.

As low as it'll go

But to expect retail food price deflation is wishful thinking, say people in the food industry and economists, who warn that retail food price inflation is at, or near, its lowest point.

“It's a tough call, but my view is that it [food inflation] is about as low as it's going to go,” says

Holding a slightly more optimistic view is Pick n Pay food director Kevin Korb, who says that though food price inflation is close to its low point, it will hold at this level for at least six months.

But consumers want to know why food prices do not drop after declines in prices at farm and factory level.

Stable demand

Ernst Janovsky, GM of Absa AgriBusiness, explains that despite recent significant job losses in SA, the demand for food has remained relatively stable. Consumers have to eat, he says.

State social welfare grants also ensure that consumers still have cash to buy food. “Social welfare payments are to a large extent being used for food purchases,” says Janovsky.

Simon Crutchley, CEO of food manufacturer AVI, says it is wrong to assume that a manufacturer's current input costs are the same as spot prices in commodity markets.

“There are leads and lags,” says Crutchley, referring to the widely used practice of buying raw materials in advance of delivery. Today's input costs for white maize, for instance, could be R1700/t, negotiated three months ago, and not the current R1100/t.

Domino costs

Though no manufacturer will disclose the prices at which they bought forward, this is why retail food prices are slow to come down. Though many major food commodity prices have collapsed in recent months, many farmers, traders and end-users were caught by surprise.

This is best reflected in the price of maize, the most significant input commodity in SA's food chain. Maize affects the cost of red meat, chickens and mealie meal, a staple for millions of people.

The maize price slump was largely due to a weather forecast that went wrong, explains Andrew Fletcher, a futures trader at Unigrain Farmers were warned that El Niño, a climate pattern originating in the Pacific, was about to strike, bringing with it widespread drought. Farmers reacted by planting more hectares. Maize users and speculators reacted by buying maize futures aggressively. But El Niño did not play ball. The rains came down and so did the maize price, by almost 40% in the first two months of 2010 to levels last seen in 2006.

Fletcher notes that at current levels, maize buyers are seeing value and are buying. But though this should ensure that consumers will benefit from lower maize input costs during 2010, other negative factors influence the food industry's input cost structure.

Other influences

Wage increases of about 8% are one factor, but more significant is Eskom's electricity tariff increase.

In the dairy industry, labour and electricity cost increases will be key drivers of cost increases, says Nick Wentzel, COO of dairy product manufacturer Parmalat. “I expect dairy product prices to rise on average by between 5% and 6% in 2010,” he warns.

At Pick n Pay, Korb says, the electricity price increase will add about R85m to the retailer's costs in the first year alone. “Pick n Pay will do everything possible to absorb this increase,” he says.

Based on Pick n Pay's results for the six months to August 2009, absorbing the full increase would have reduced its trading margin from 2.75% to 2.6%.

World Cup factor

Another factor that cannot be ignored is the soccer World Cup, says Janovsky. If upwards of 450000 foreign visitors attend the five-week event, as predicted, demand for food products should increase significantly. UK financial services company Virgin Money estimates that 50000 England fans will attend and spend, on average, about R47000 each on food and accommodation.

There are signs that the World Cup is already affecting the red meat market.

“Local meat prices have risen 5%-6% in the past few weeks,” says Pierre van Tonder, MD of restaurant group Spur “It's hard to understand; we should not be seeing price increases,” he adds, pointing to positive weather conditions and well-stocked cattle feedlots.

Just how far overall food price inflation will rebound is hard to say, but Sanlam economist Patrick Buthelezi says a rise to 2.7% in 2010 is likely.

Stock levels keep prices in check

Little price pressure is likely to come from wheat, of which SA is a net importer, or maize. The wheat price has slumped by a third over the past year and is expected to be held in check by stocks which Australia's Bureau of Agricultural & Resource Economics predicts will reach a record high in 2010.

High stock levels of maize in SA are also likely to hold prices in check. Nico Hawkins, industry service manager at agricultural specialist Senwes, says this season's bumper crop will add up to 3Mt to a carryover stock from the 2008/2009 season of about 1Mt. It will take up to two years to clear the surplus.

But the maize surplus is also a potential trigger of the next surge in food prices. At current prices, says Hawkins, the average maize farmer will pocket between R800/t and R1000/t, well below total costs of around R1200/t and variable costs of up to R900/t.

Machinery sales drop

Signalling their predicament, farmers bought 31% fewer new tractors in February than a year earlier, reports the SA Agricultural Machinery Association. Combine harvester sales fell 64%. The association attributes the slump to recent falls in grain prices at a time when farmers' cash resources are “very low”.

Add the banks' reluctance to extend credit and there is good reason to expect that the next season's crop will be far from a record one.

Source: Financial Mail