24 April 2023

Food inflation

Divergent trends across regions

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Economics - Global

- Currently soaring food inflation is keeping headline inflation high, offsetting the decline in energy prices…
- …particularly in Europe where food inflation has yet to peak for a number of reasons…
- …but there are more promising signs in Asia and Latam

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Food fight

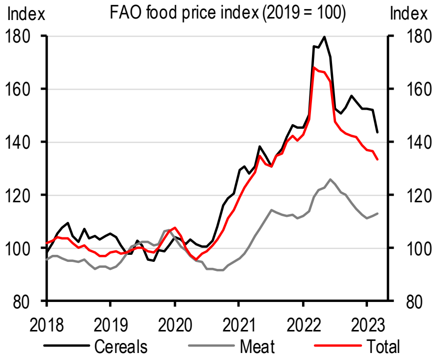
Global inflation may have peaked but is still far too high. And now, in many places, as energy inflation has fallen back, food price inflation has become the pressing concern for households.

There have been some improvements in wholesale food prices. The benchmark index for international food commodity prices – which includes cereals, vegetable oils, sugar, meat and dairy prices – hit its highest in March 2022 (Chart 1 and 2) in the aftermath of Russia invading Ukraine. It then fell for the twelfth straight month in March 2023 but that still leaves the wholesale price level some 30% higher than pre-pandemic levels. So many regions are still seeing extremely high food price inflation.

This is partly because there is a substantial lag between the prices farmers receive and the prices households pay. End prices include processing, packaging, transportation and distribution and so all of these factors feed into food inflation rates.

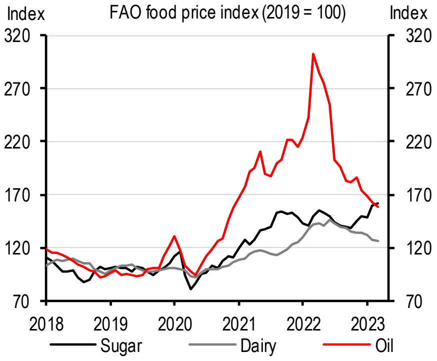
Food inflation is seemingly yet to peak in Europe, MENA and some African countries, but there are signs of a turn in some Asian economies and Latin America. Given that the weight of food in CPI baskets is usually larger in EM economies, the impact on household incomes and inflation is greater.

1. Global food prices have likely peaked, but remain elevated



Source: Refinitiv Datastream, HSBC

2. Sugar prices are still on the rise due to limits on Indian exports



Source: Refinitiv Datastream, HSBC

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A mixed bag

The food inflation story varies from region to region. For some economies it is still rising, as in most of Europe, while in others it has started to moderate, as in Asia. On the other hand, some economies have very specific stories relating to food inflation which are worth noting.

In the US, food inflation has eased for the last six months, with March's print at 8.5% y-o-y showing a broad based slowdown in almost all food components. That said, while inflation for food at home is coming down, restaurant food inflation is showing no sign of turning. On top of raw food prices, rentals and wages are keeping cost pressures high. Average hourly earnings growth for leisure and hospitality services, although moderating, is higher than other sectors, adding to inflationary pressures in restaurants.

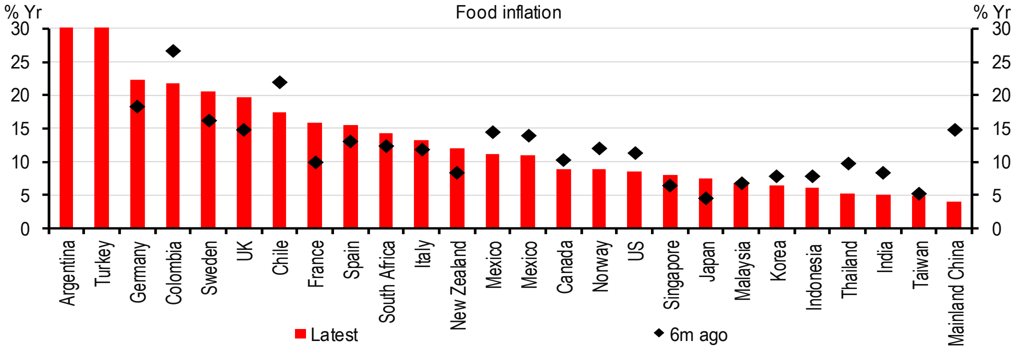
Meanwhile, there are a few food items such as eggs, bread, dairy products and pork which remain at a high level. In particular, egg prices, although moderating, are still expensive in the US due to the recent avian flu. The deceleration in food price inflation over recent months will be important to monitor going forward, as it may be indicative of a broader reduction in inflation pressures. We expect food prices to rise further over the remainder of this year, but not as quickly as in 2022.

In Europe, especially in the eurozone countries, food inflation continues to rise. In March, prices of food, alcohol and tobacco rose 15.4% y-o-y in the eurozone. While the rapid drop in energy inflation as global oil and gas prices eased may have provided some comfort to headline inflation, higher food prices are now contributing more to headline numbers. Policymakers are especially focusing on how to control food inflation. Already facing protests against pension overhauls, French President, Emmanuel Macron, last month sealed an agreement with leading retailers to limit the rise in food prices. That said, higher energy prices earlier in Europe have also lifted costs of production for farmers which are being passed along the supply chain.

The story is less daunting in Asia. In most economies, food inflation has already peaked. However, some anomalies are worth noting. For example, in mainland China and Taiwan, higher pork prices due to swine flu have put some upward pressure on food inflation. In India, rice and processed wheat prices are quite high. Interestingly, raw wheat prices are falling sharply. Meanwhile in ASEAN, the Philippines is reporting relatively high inflation. The government's recent move to support import substitution has led to a supply-demand imbalance, resulting in higher prices of certain food items, in particular onions, sugar and mackerel scad.

Likewise, in LatAm, food inflation has already peaked, with the exception of Argentina. In fact, Brazil's March inflation came in below market expectations with food driving the downward surprise. Elsewhere, the World Bank predicts double-digit food inflation in MENA economies in 2023, after above 25% food inflation in 2022. This is putting an intense squeeze on incomes in many African economies, where the weight of food is higher in the CPI basket. Hence, food security and lower growth are the major concerns for these economies currently.

3. Food inflation may have peaked in some economies, but keeps rising in Europe



Source: Refinitiv Datastream, HSBC. Note: Latest and 6m ago inflation in Argentina is 106.6% and 88.6% respectively, while that in Turkey is 67.1% and 92.4% respectively

Why is there a divergence?
Let us delve a bit deeper into why are we seeing such different food inflation shocks in different economies. In particular, why is Europe, in particular, still seeing such high food inflation?

Higher energy and fertiliser costs: In Europe, a key contributor to higher food inflation has been rising energy costs. Higher energy and fertiliser costs deterred farmers from producing as much crop or raising as many animals in 2022 as well as seeing higher production costs for foodstuffs that leave the farm. That said, authorities are now focusing on consolidating food stocks and with wholesale prices dropping, we hopefully should see the impact on prices soon.

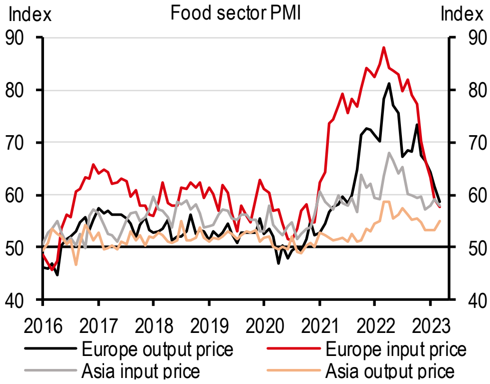
Supply chain disruption: On top of higher energy prices, the Russia-Ukraine war resulted in more disruption to food supplies in Europe rather than in Asia. For the European livestock sector, Ukraine exported 15% of all maize (11mn tonnes annually to the EU) and 61% of sunflower cake, which are important inputs in animal feed. Russia had targeted agricultural production facilities in Ukraine, and Moscow's blockade of Black Sea routes virtually halted Ukraine's agricultural exports (about 80% were seaborne) until the UN-brokered Black Sea Grain initiative and EU solidarity lanes which allowed safe transport. The UN extended the Black grain initiative again on 18 March. However, there is still uncertainty around how long the Black Sea Grain Initiative will be extended.

Trade restrictions: Another reason for the sudden spikes in food is because of a growing number of food trade restrictions put in place by different countries to maintain their domestic supply. For example, in February multiple countries imposed export restrictions on onions, tomatoes, potatoes and carrots to stabilise their domestic prices. In January, Mexico announced a temporary 50% tax on white corn exports. Last October, mainland China put in a ban on corn starch exports and Bolivia banned exports of soybean, soybean meal, soybean flour, sugar, oil and beef. Even the global rise in sugar prices was due to the ban on sugar exports from India implemented last June and has been extended until October this year. These bans, while helping domestic prices, raise food prices for importing countries.

Margin squeeze by food producers: While this is an unsurprising result of the cost pressures described above, EU food suppliers saw a huge run up in input costs and as they come down, they seem to be trying to restore margins, keeping prices of final products high. There were some reports of "greedflation" in the UK where businesses are fuelling inflation by lifting prices more than warranted by their costs (The Guardian, 19 April, 2023). On the contrary, Asian economies didn't see this impact and, even though input costs rose, it was by less than in Europe – and so prices may be less sticky on the way down (Chart 4).

Adverse weather events: The other reason for higher food prices is unforeseen weather events. In India, unseasonal rains and hail storms have damaged ripening, winter-planted crops such as wheat (Reuters, 21 March). Additionally, a depletion in cereal stocks could push cereal prices higher in the coming months. Similarly, the extreme hot weather in Europe in August 2022 resulted in drastic falls in harvests of multiple crops including potatoes, onions, sugar beet, apples, maize, soybeans and sunflowers. Fortunately, the World Meteorological Organisation

4. Input costs for food producers in Europe rose higher than that in Asia

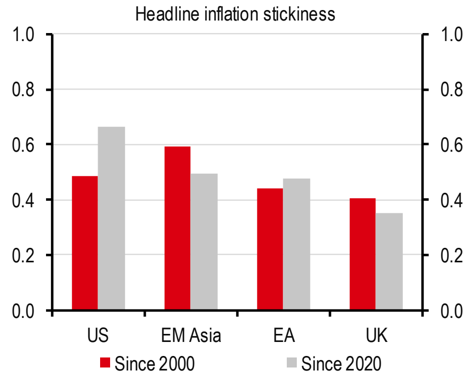


Source: S&P Global, HSBC

5. Ukraine accounts for a high share of EU imports for cereals and edible fats

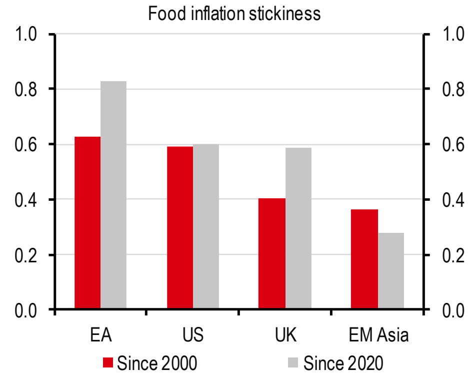
Source: Eurostat, HSBC

6. Headline inflation turned stickier in the last three years in the eurozone…



Source: Refinitiv Datastream, CEIC, HSBC. Note: EA denotes Euro Area. Note: Based on how previous month's inflation affects this month's inflation. Uses non-linear least square technique (ARMA) to look at how one month's inflation print drives the next – data shown are impact on inflation in period t from inflation in period t-1.

7. …as food inflation has become stickier



Source: Refinitiv Datastream, CEIC, HSBC. Note: EA denotes Euro Area. Note: Based on how previous month's inflation affects this month's inflation. Uses non-linear least square technique (ARMA) to look at how one month's inflation print drives the next – data shown are impact on inflation in period t from inflation in period t-1.

predicts a 90% chance for a transition to ENSO-neutral (which means Neither El Niño or La Niña) during March-May 2023, which could help reduce food price volatility. There is a small chance (of about 10%) for La Niña to continue further.

How persistent is food inflation? We have analysed how sticky inflation is across the US, Europe and Asia. Our results show two things: firstly, food inflation is stickier than headline inflation. Secondly, prices in the eurozone have become stickier in the last few years than prices in EM Asia and the US (Chart 6 & 7). We have used seasonally adjusted sequential changes in headline and food inflation for the analysis and have used oil prices as a control variable, too. For this particular analysis, we have taken two time periods: one since 2000 and second since 2020. The analysis suggests that prices in EM Asia are more persistent than prices in the West for the longer time period, but that has changed in recent years. Prices in the eurozone seem to be stickier than other regions for the last three years. Typically, a lot of food and fuel prices in Asia are subsidised or controlled, which in general makes inflation more persistent. But in recent years, the spike in energy prices might have reversed the trend, i.e. food inflation in the eurozone has become stickier than in the US and Asia.

According to the model, a one percentage point rise in food inflation in the current period in the eurozone implies an increase in food inflation by 0.83ppt in the next period, assuming everything else remains constant. This suggests that Europe may see stickier food price pressures in the months to come. That said, a recent report from the European Commission shows that selling price expectations for food and beverage services had declined for the last two months. Usually HICP tends to follow the same trend, but with a lag and we might see some easing pressures in a few months' time.

That said, in Asia some countries prioritise the need to maintain a stable supply of foodstuffs to keep prices at bay. For example, in Indonesia, the government ensures sufficient imports of food items such as rice to maintain the domestic supply. On the other hand, the Philippines' government is trying to use import substitution as a mechanism to control food inflation in the country. While inflation of food items such as onions and fish are very high in the Philippines, the government believes that this strategy would bring down food inflation sooner.

Overall, the task for central bankers remains challenging. Food inflation is typically hard to tackle with monetary policy, but given how high it is in Europe in particular, it is playing a key role in keeping overall inflation well above central banks' targets. Unless lower wholesale prices start feeding into CPI prints soon, food inflation may be a concern for a while longer. That said, we believe higher food prices are transitionary and should ease with time. But the second round impact due to inflation persistence makes it difficult for central bankers to look through it. Hence, we still expect more rate hikes from the US Fed, BoE and ECB.

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