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The recent rise in cereal prices: will it last ? what impact on food prices ?

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Structure of the presentation

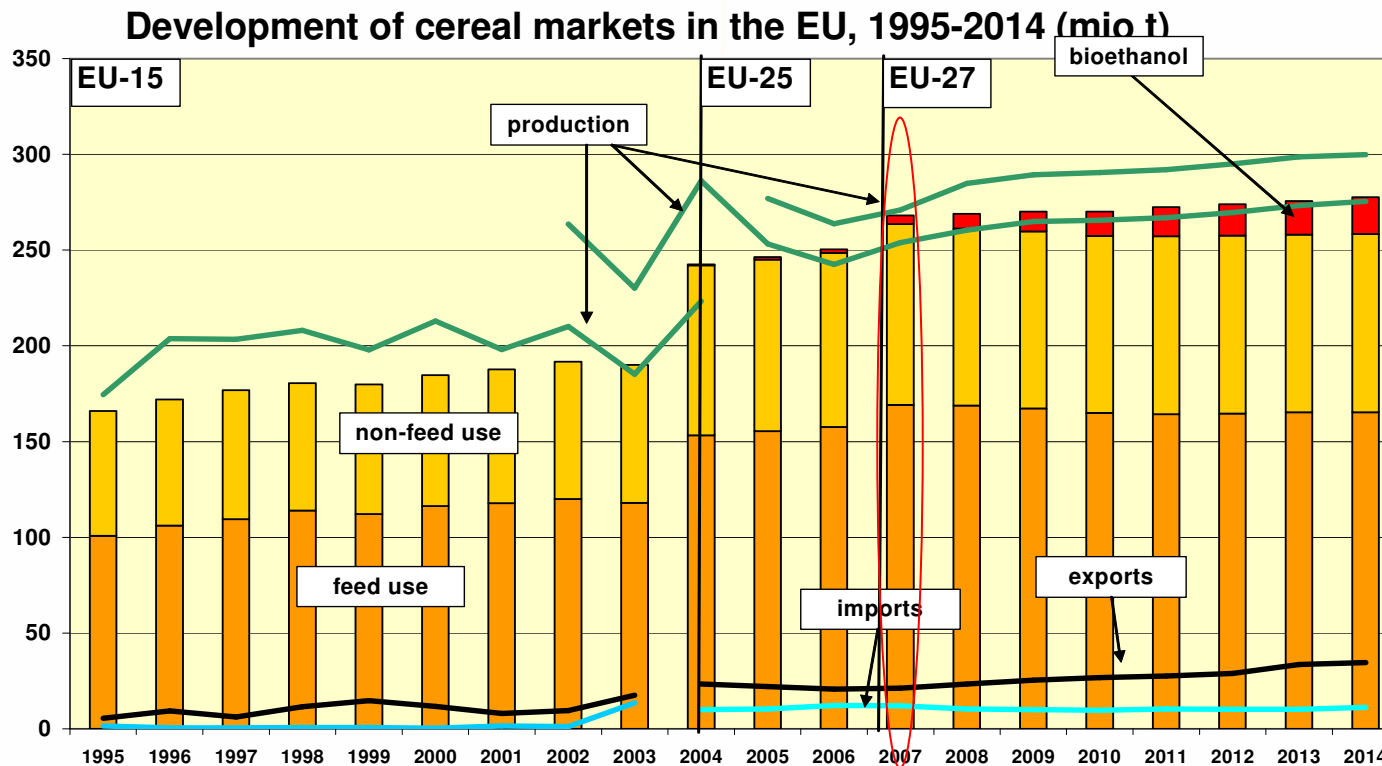
- Cereal prices
- Impact on food prices and consumers
- Conclusions

The July 2007 perspective



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Slightly expanding cereal markets and emerging bioethanol markets....



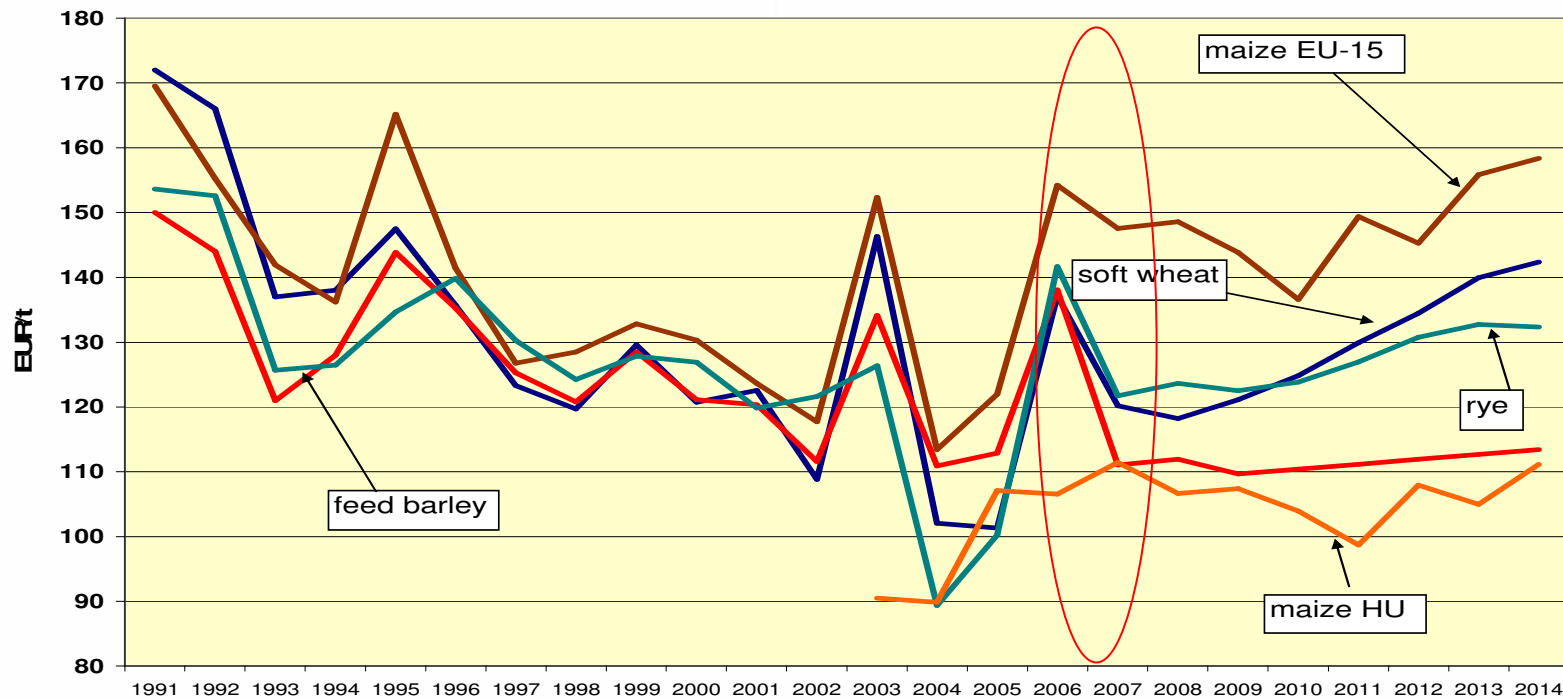
The July 2007 perspective



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with cereal prices staying firm over the medium term.

Development in cereal prices in the EU (EUR/t), 1991-2014

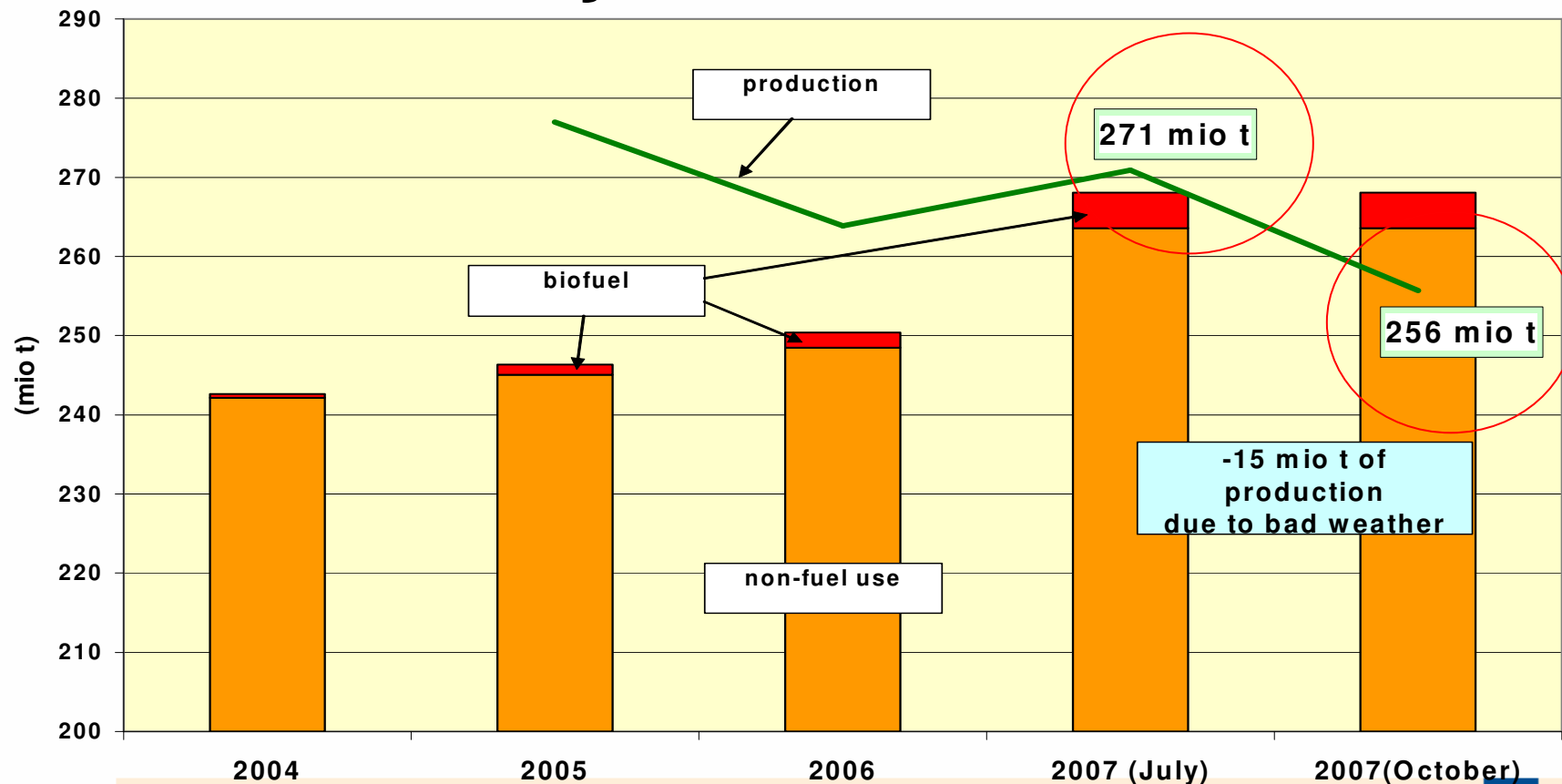


The situation today



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A considerable drop of the EU cereal harvest this year....



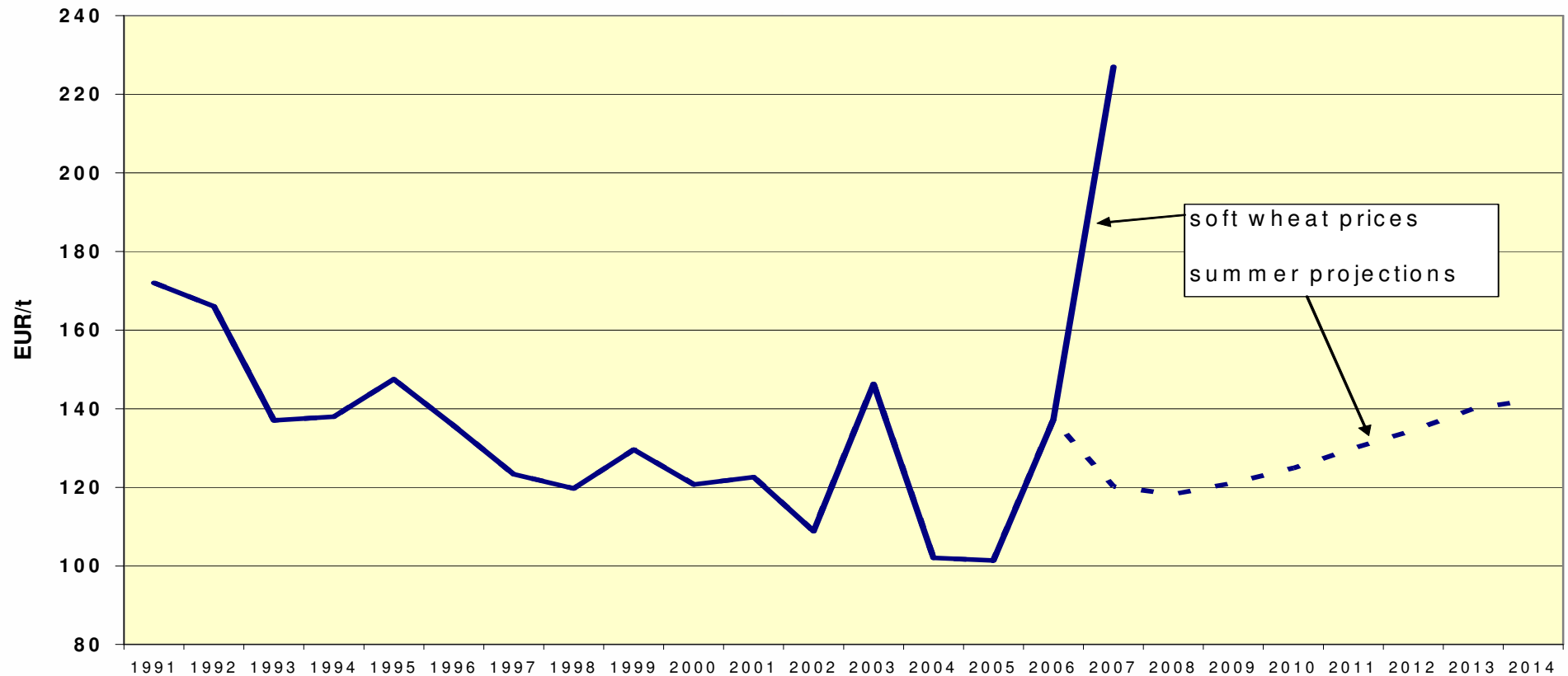
08/11/07 AGRI G-2 „The recent rise in cereal prices“. Cereals ManCom.

The situation today



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...with a large impact on EU prices.



08/11/07 AGRI G-2 „The recent rise in cereal prices“. Cereals ManCom.



Why this large impact on prices?

- demand is relatively stable:
 - animals are in place
 - consumers don't cut consumption (because they hardly feel the price increases)
- bad harvest also in other places of this world
- second global low harvest in a row meets historical low cereal stock levels
- globally there are only two harvests in a year (northern and southern hemisphere)



What was foreseeable? – or what are the medium term prospects about?

- **structural factors**
 - increasing demand in emerging economies (change in dietary pattern,...)
 - increasing demand due to new industrial uses (biofuel, chemical industry...)
 - lower harvest potential in Australia due to a series of adverse weather conditions,
 - low levels of global stocks due to long term policy changes in developed countries
- **result in firm price levels for cereals over the medium term**



What was not foreseeable?

- **conjunctural factors** (those seen in July included)
 - exceptionally bad weather conditions during harvest in most parts of Europe (too hot, too wet, too cold)
 - significant downward revisions of harvest prospects in other parts of the world
 - restrictive export policies in Russia and the Ukraine



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Reasons for price pressure relief:

- **high prices cure high prices:** mobilisation of land, increase of production intensities, shift from other production to those where the gains are higher (e.g. from biogas, fodder production to cereals)
 - evidence: record maize harvest in the US, land mobilisation in the EU

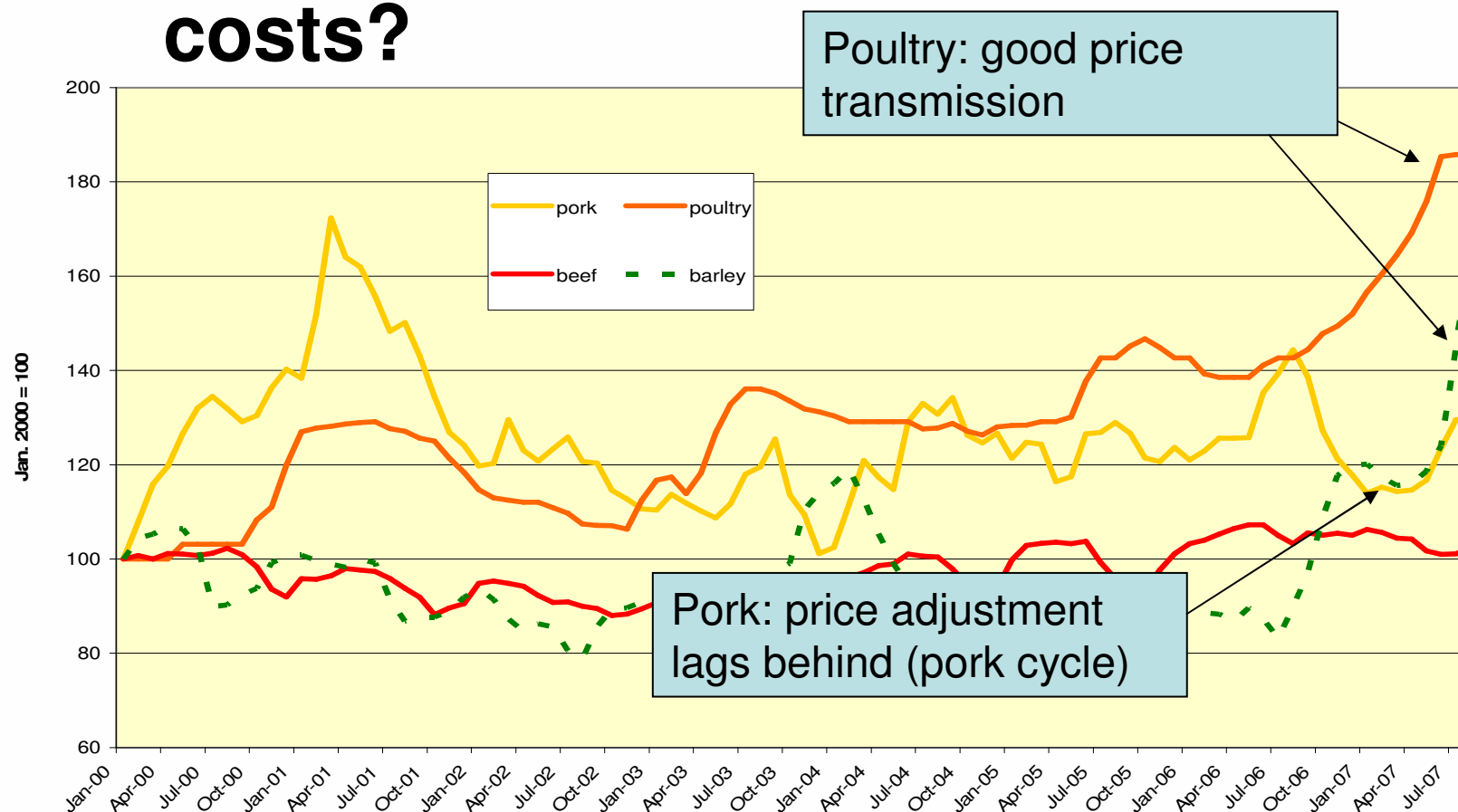


Impact of high cereal prices on animal feed:

- feed rations are largely based on cereals (e.g. pork, poultry 70% of the feed)
- feed costs represent 60-70% of the production costs.
- Should cereal prices remain at this level,
 - feed costs for pork and poultry would increase by 38%
 - feed costs for beef would increase by 6%



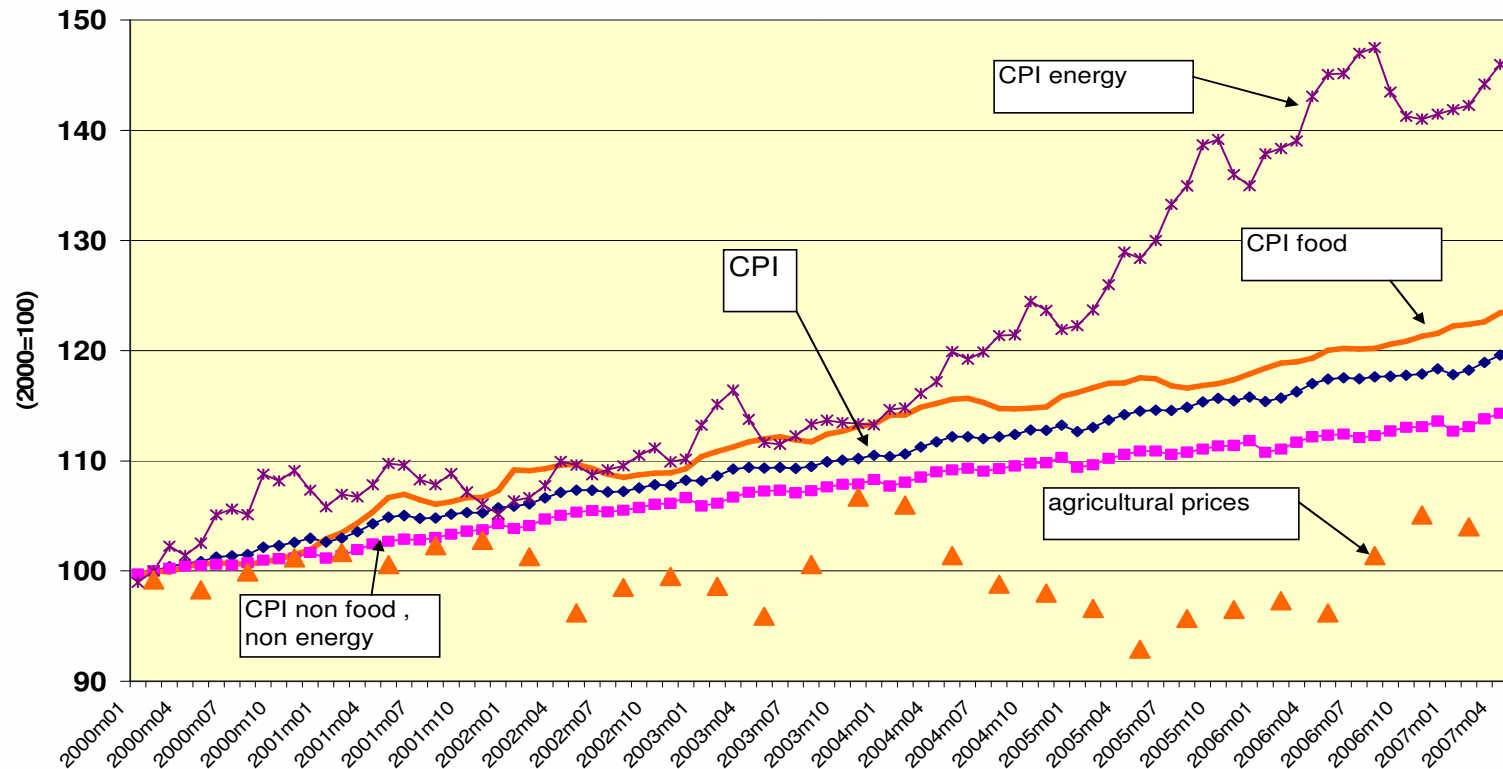
Do producer prices reflect higher feed costs?





Agricultural prices lagged behind in the development of consumer prices for food ...

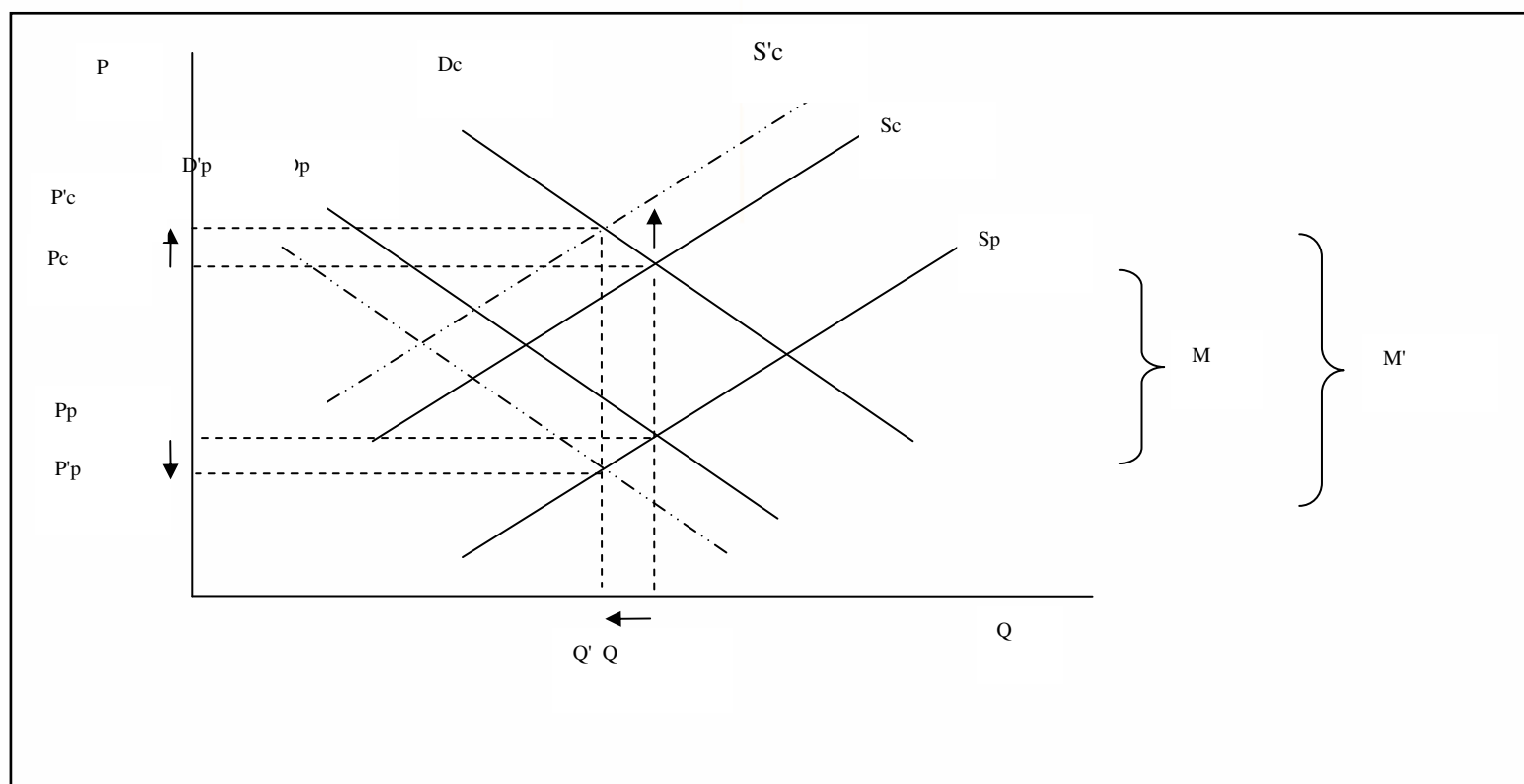
Development of nominal agricultural producer prices and consumer prices in the EU (Jan. 2000=100)





...with increasing trade and processing margins aggravating price pressure on agriculture

Margin extension through price increase in complementary goods and services





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Food prices should be affected by higher agricultural prices to a much lower extent due to ...

- Low share of agricultural products in total cost of food (cereals, processed meats, dairy products ...) trigger a limited increase in final consumer prices;
- Competitive structure of the agri-food sector: no evidence of partial transmission of price changes from producers to consumers (though this may happen in the short-term in some sector/country specific situation)



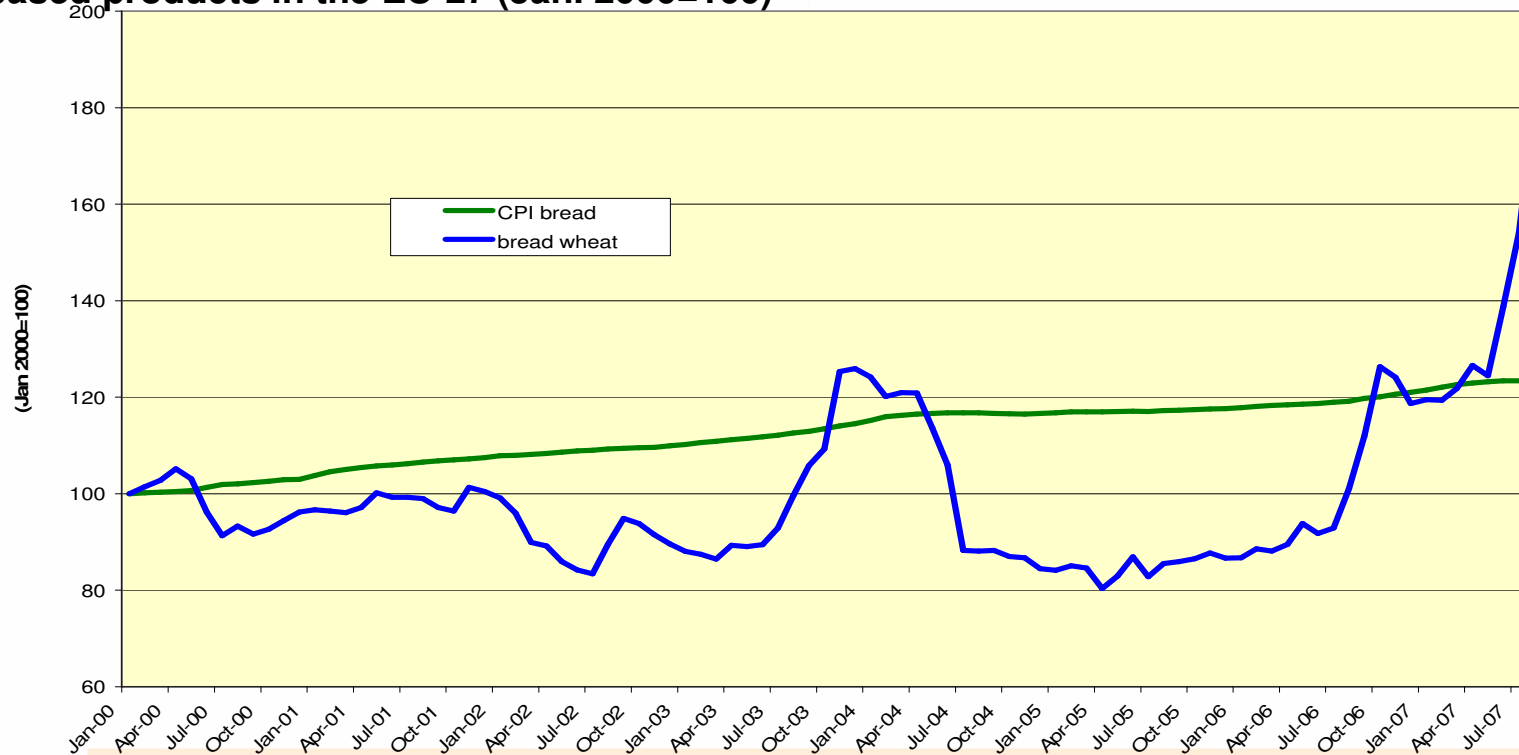
Share of agricultural raw product value in retail product value (1970 – 2002, Germany)

Financial year	Bread cereals and respective products	Table potatoes	Sugar beet and sugar	Plant products altogether	Slaughter animals, meat and meat products	Milk and dairy products	Eggs	Animal products altogether	Total
1970/71	19	63	42	33	48	57	84	52	49
1979/80	15	46	44	25	46	60	80	51	46
1985/86	11	36	40	19	42	56	73	48	42
1988/89	8	33	38	14	36	56	70	44	36
1994/95	5	45	38	13	29	44	67	35	29
1995/96	4	37	37	11	29	45	74	36	29
1998/99	4	37	39	11	20	40	55	29	24
1999/00	4	28	40	10	23	40	59	31	25
2000/01	4	26	39	10	26	45	69	34	28
2001/02	4	33	38	9	22	42	68	31	25
2002/03	4	24	38	9	21	39	68	29	24



This is why, historically consumer prices for bread/cereal based products were hardly affected by peaks in producer prices ...

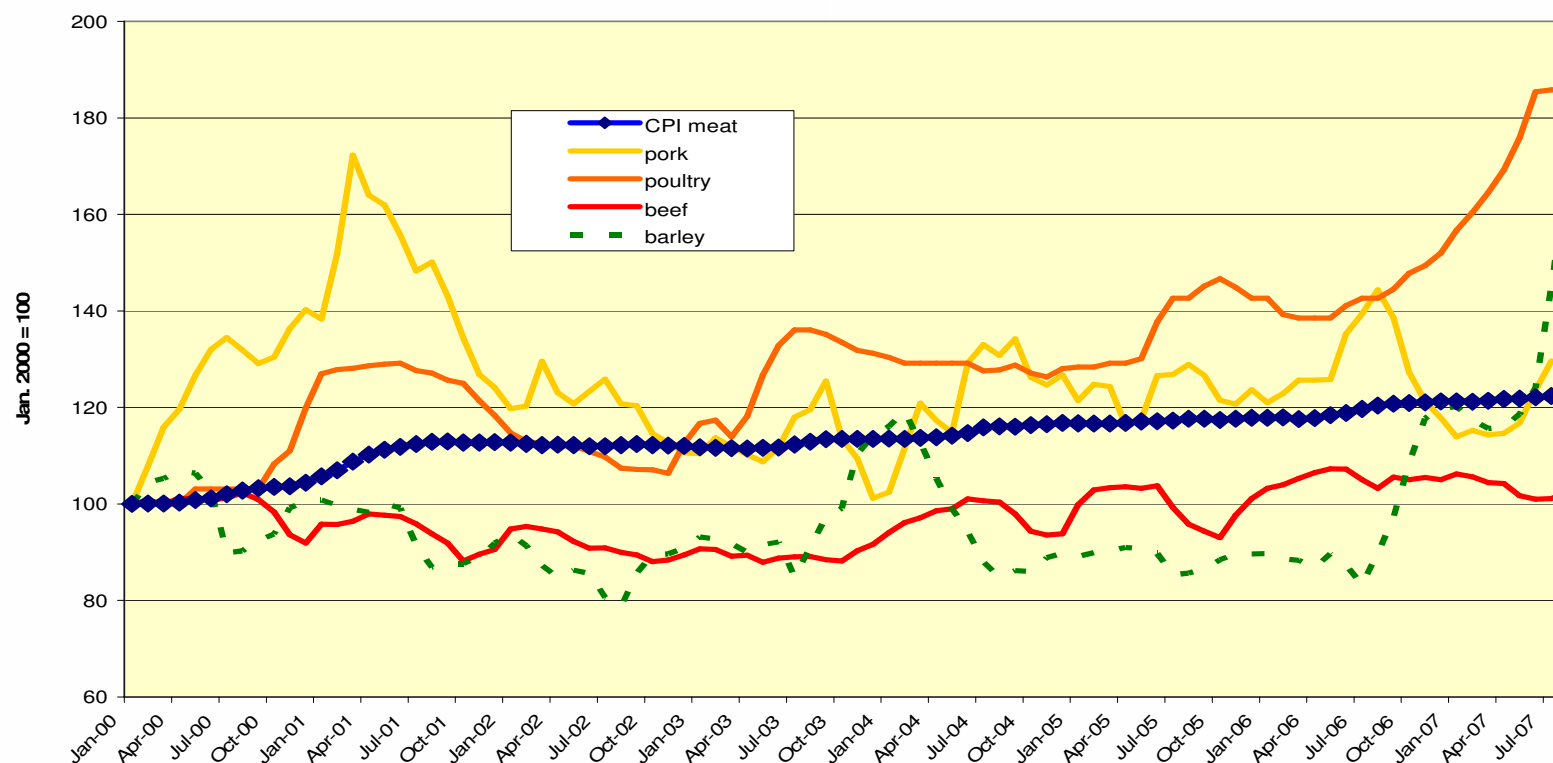
Development of producer prices for bread making wheat and consumer prices for bread and cereal based products in the EU-27 (Jan. 2000=100)





... consumer prices of meat products steadily increase while meat prices react with delay to higher feed prices

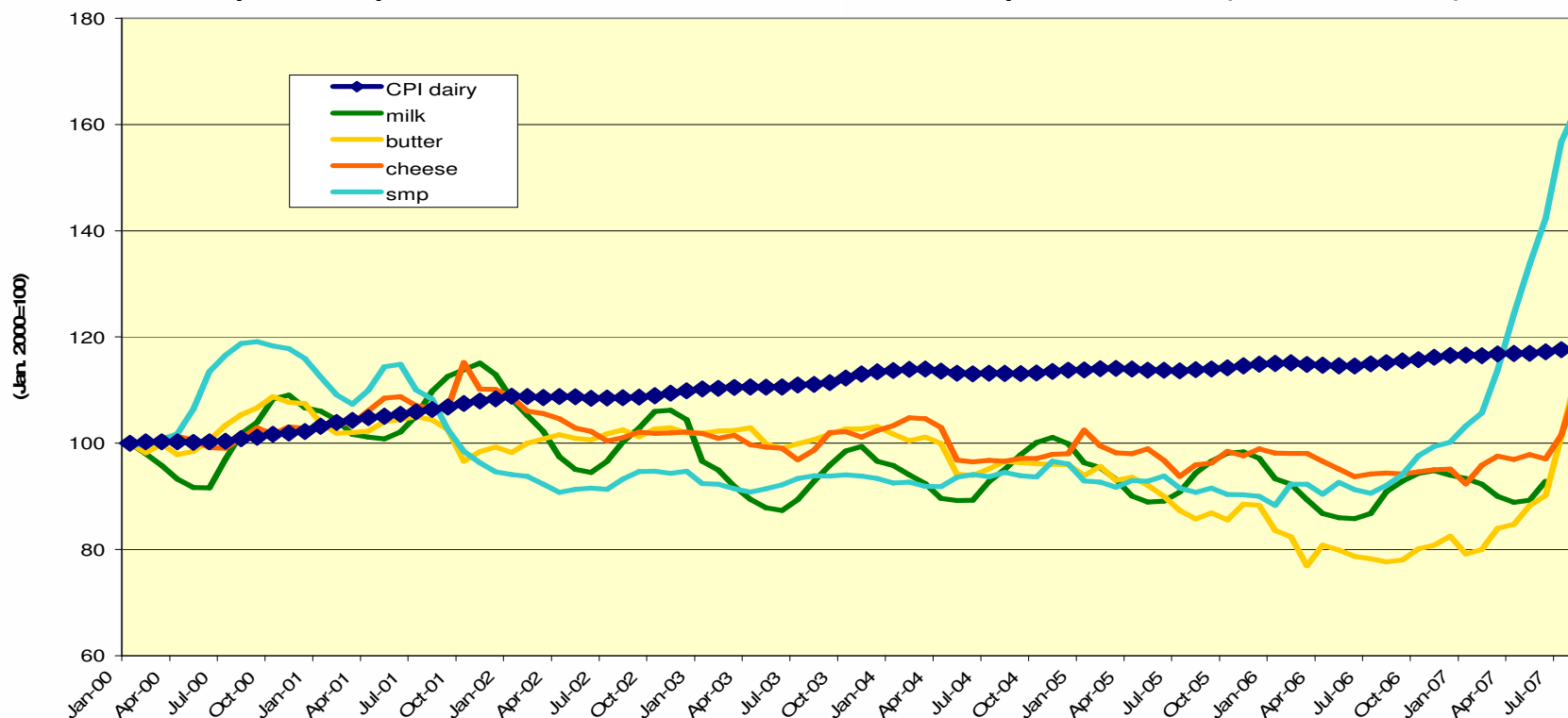
Development of consumer prices for meat, producer prices for beef, poultry, pork and feed barley, EU-27 (Jan. 2000 = 100)





... consumer prices for dairy products were hardly affected by bulk commodity prices....

Development in the consumer prices for dairy products, the producer prices for butter, cheese and skimmed milk powder, EU-27 (Jan. 2000 = 100)





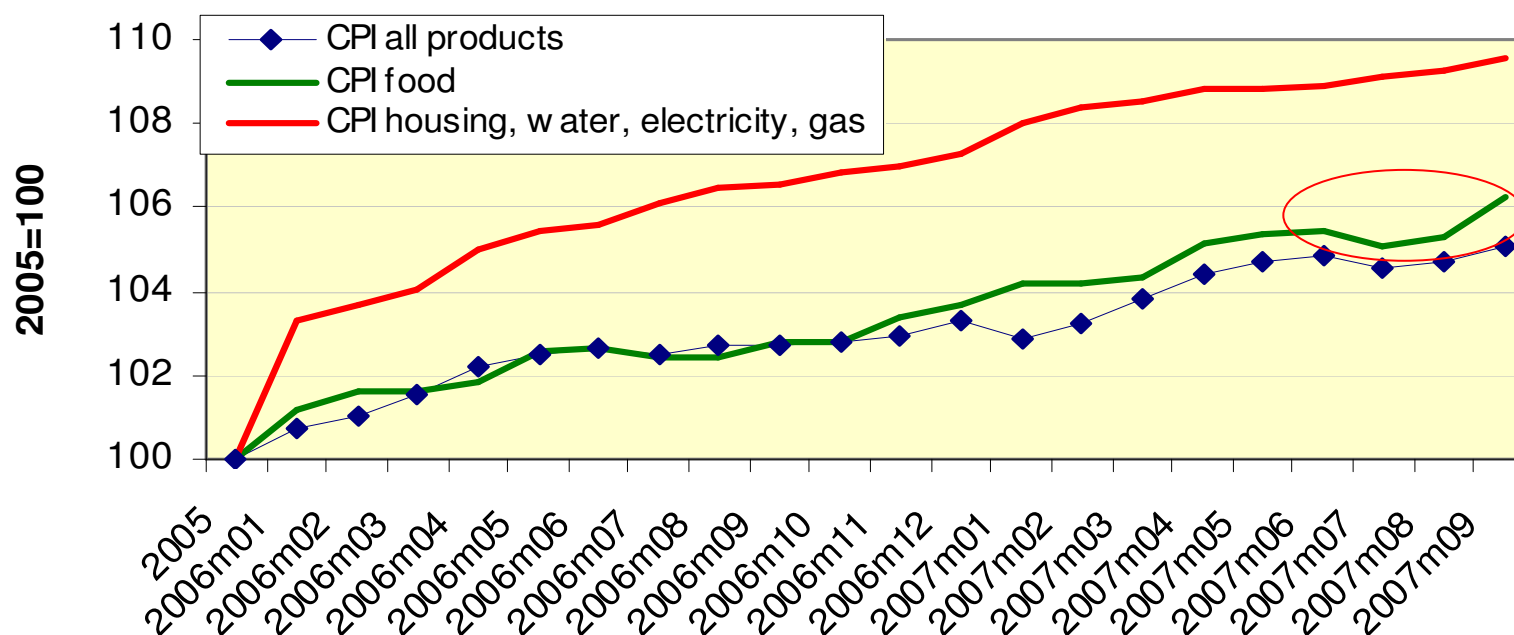
In summary, the relatively large producer price increases should lead to a limited increase in consumer prices...

Change in agricultural producer prices		Theoretical impact on consumer prices		
		short-term (real change in HCPI Aug 07/06)		medium-term
August 2007/ August 2006				
Wheat	78%	Bread	4% (bread and c.b.p: 4%)	4%
Poultry	30%	Poultry	6%	8%
Pigs	-10%	Pigs	-2% (meat products: 2%)	7%
Cattle	-1%	Beef	0%	1%
Butter	46%	Butter	32% (oils and fats: 0%)	32%
Cheese	18%	Cheese	9% (milk, cheese, eggs: 3%)	9%



...which is actually reflected in monthly consumer price statistics until September 2007

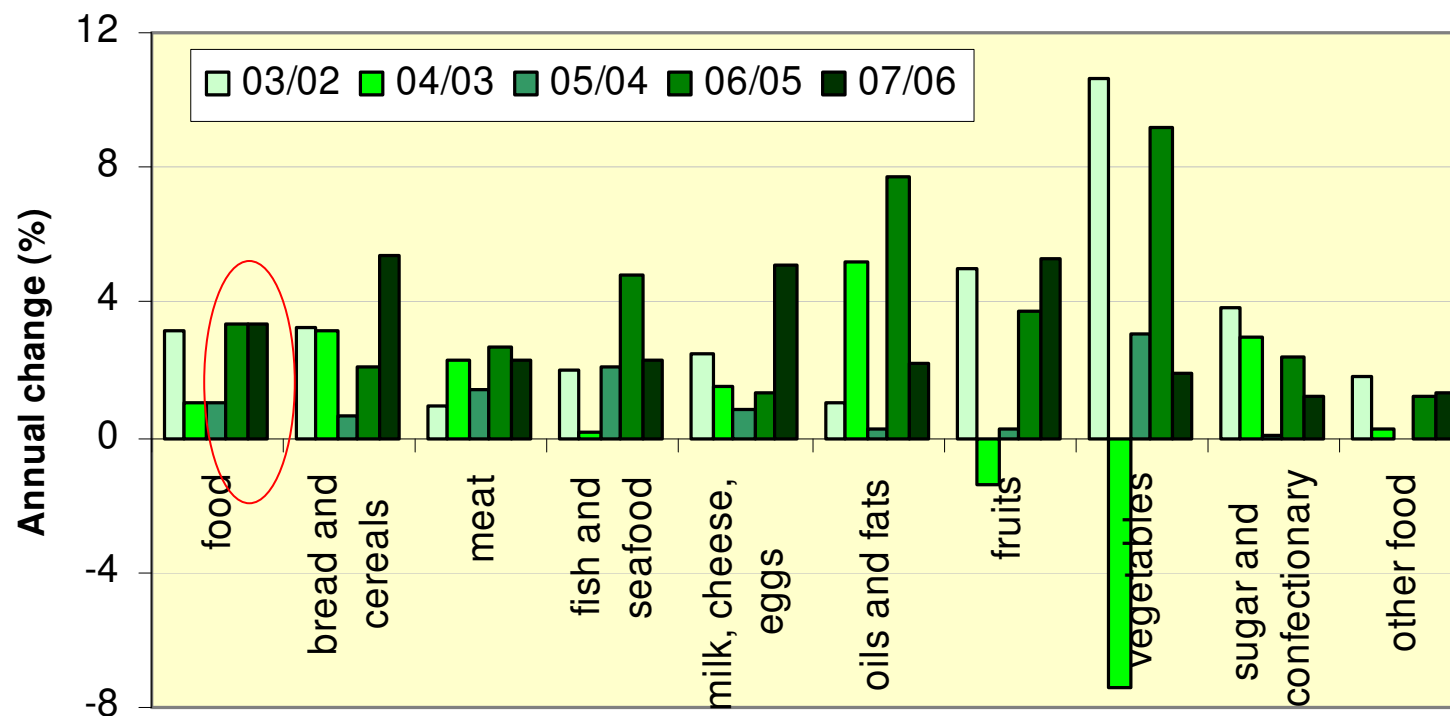
Development of EU-27 consumer price indices for different items (2005=100)





Recent consumer price developments are still in line with their longer-term trend...

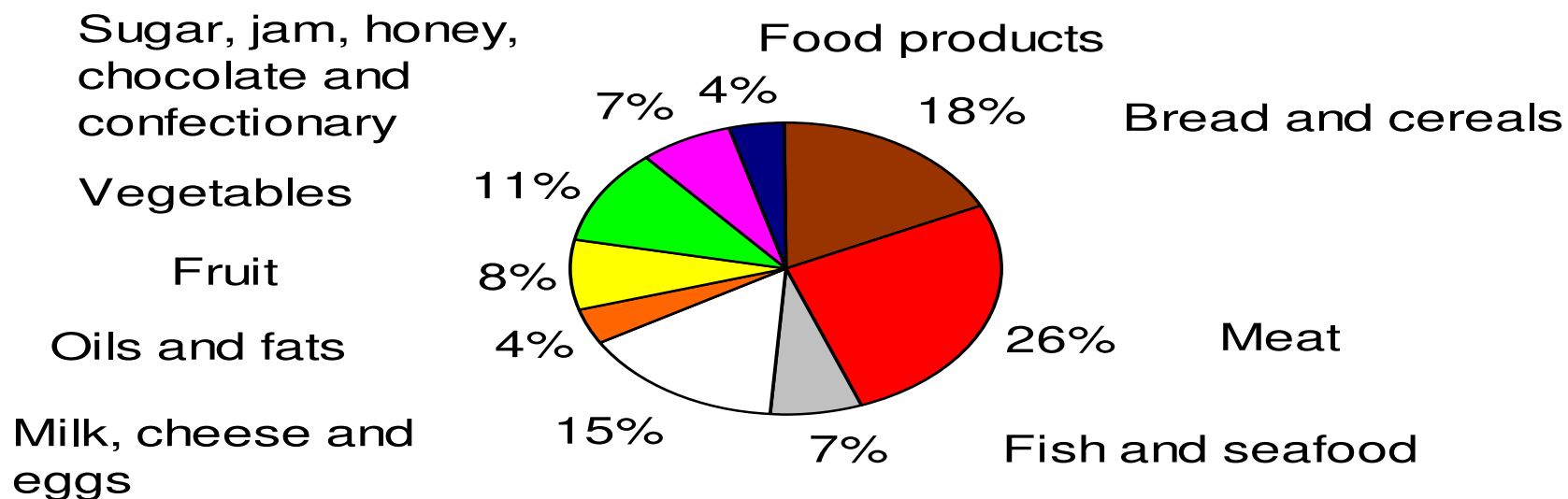
Annual changes (September) in EU-27 consumer price indices for different food items (2003/02 until 2007/06)





...with the impact on a households food expenditure depending on its food consumption pattern

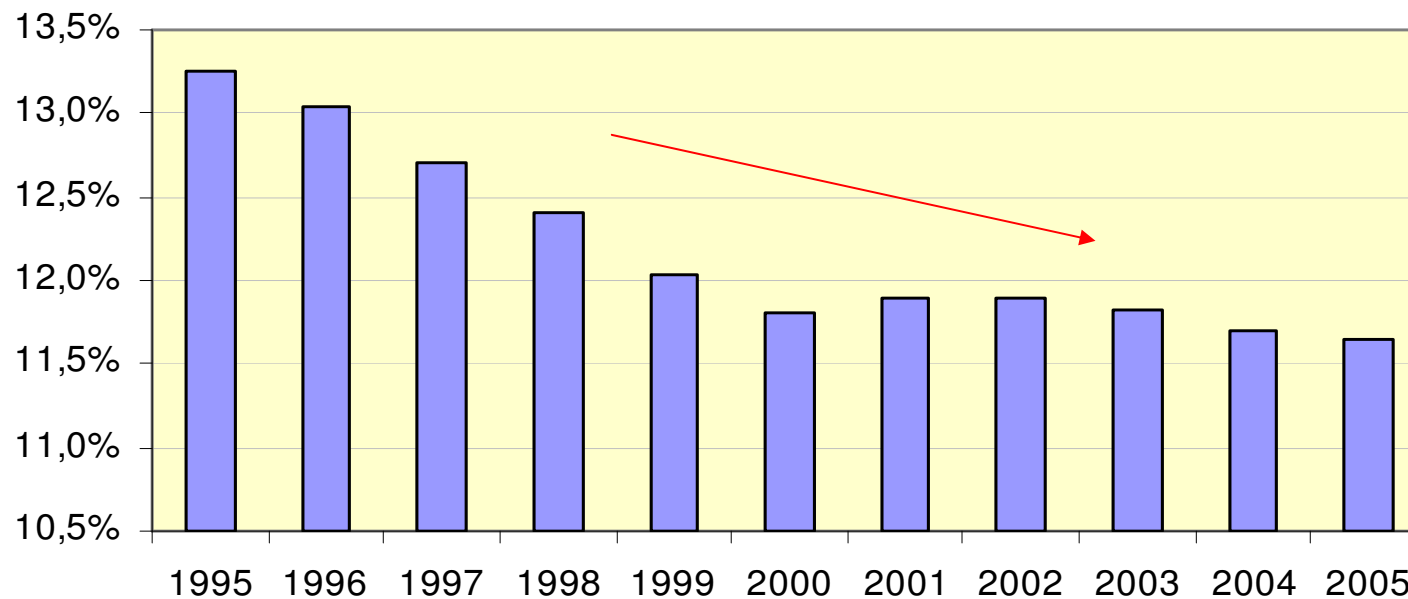
Share of major product groups in total food expenditure of an average EU household in 1999





The impact on consumers will be further limited by the declining share of food in total household expenditure....

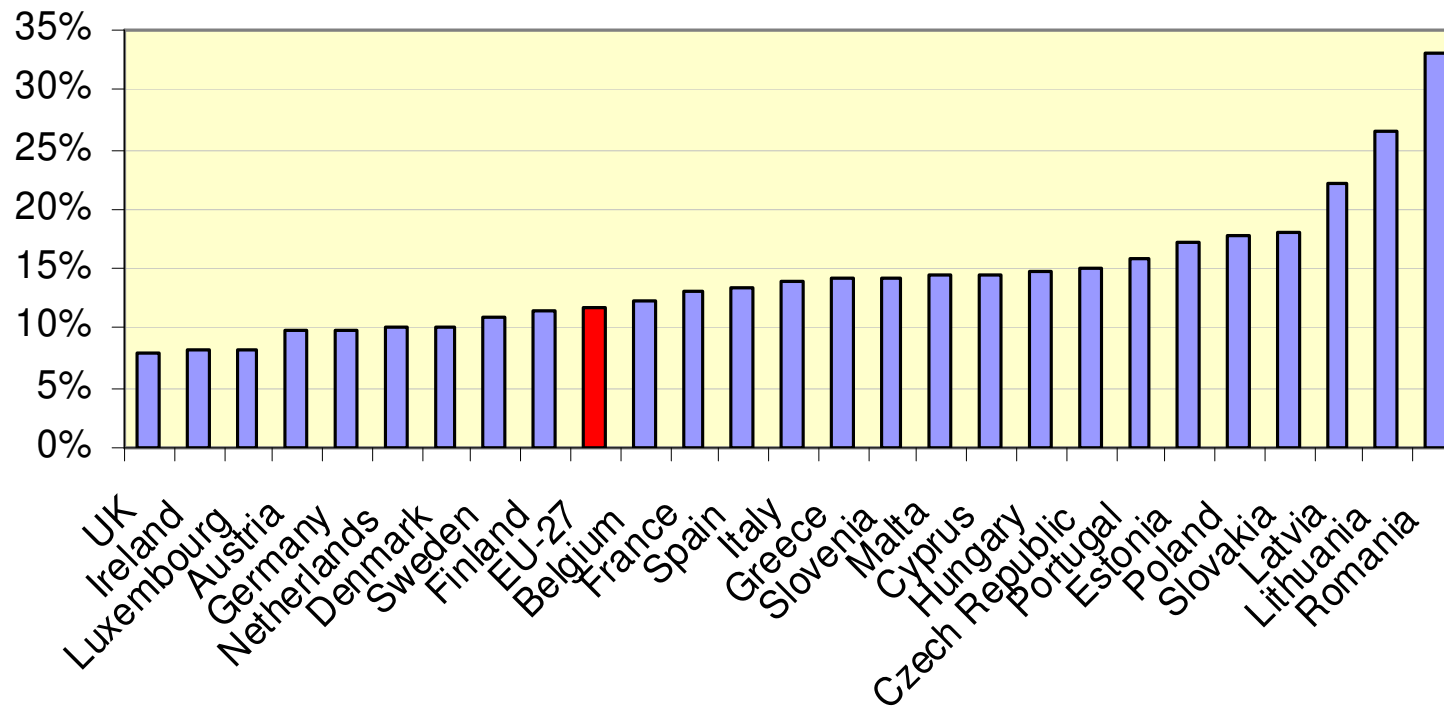
Share of food expenditure in total household expenditure in the EU over the last decade





...with a mixed geographical impact

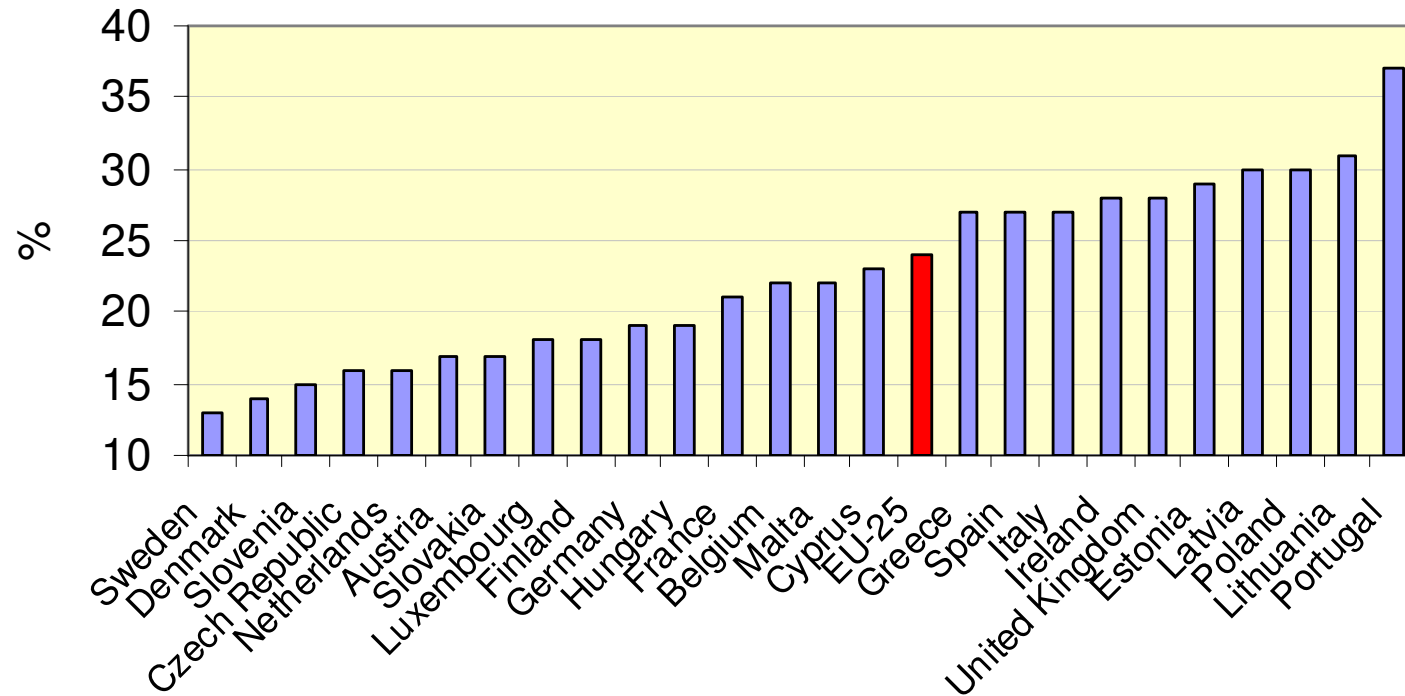
Share of food expenditure in total household expenditure by Member State in 2005





The poorest part of the population will be mostly affected

Share of population at risk of monetary poverty in 2005 (cut-off point: 60% of mean equivalised income)



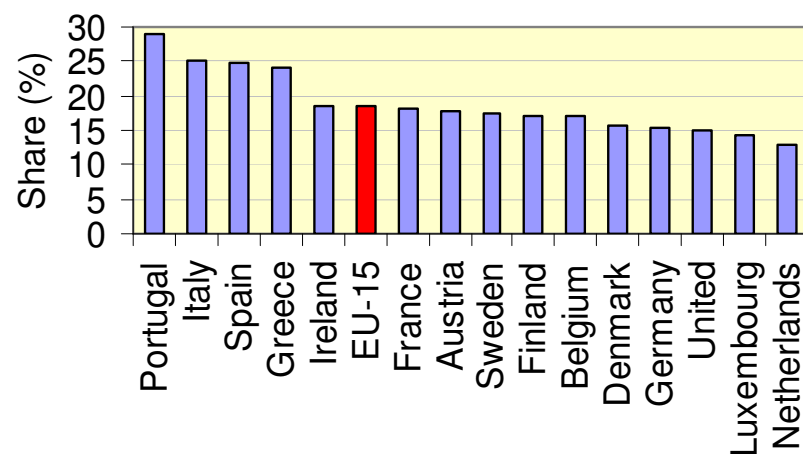


...owing to higher food shares in their spending

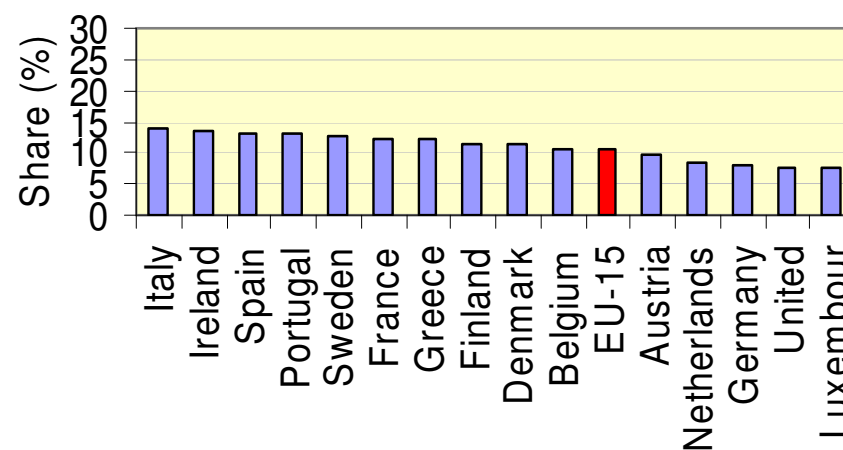
- Highest share of food expenditure with 29% in low-income households in Portugal
- Lowest share of food expenditure with 7 % in high-income households in Luxembourg

Share of food expenditure in total household expenditure by Member State in the poorest and richest households in the EU-15 in 2001

First quintile



Fifth quintile





General impact on consumer expenditure and purchasing power limited:

- Over the short term: consumer food expenditure would rise by 1.1% and its purchasing power would decrease by 0.1%
- In the extreme case that the exceptional August prices were to persist and to be fully transmitted, consumer food expenditure would increase by 8% and its purchasing power would drop by 0.9%



Conclusions I

Recent increase in cereal prices:

Will it last?

- cereal prices will stay higher over the next 10 years *but not at this exceptional level (structural reasons)*
- meat prices will reflect the higher feed costs, poultry does it already



Conclusions II

Recent increase in agricultural prices: What impact on consumers?

- Moderate impact on average EU consumers (low share of raw product value in end product value, low share of households food expenditure in total household expenditure)
- Low-income households to be more affected (higher share of food expenditure and less flexibility to adjust)
- Risks of shortage of food appear low (as supply potential can be mobilised and high prices should lead to higher production)