Food Prices to Rise by Up to 40% Over Next Decade, UN Report Warns

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Growing demand from emerging markets and for biofuel production will send prices soaring, according to the OECD and the UN Food and Agriculture Organisation

by Katie Allen

Food prices are set to rise as much as 40% over the coming decade amid growing demand from emerging markets and for biofuel production, according to a United Nations report today which warns of rising hunger and food insecurity.

Somalis protest over high food prices during the spike of 2008. Farm commodity prices have fallen from their record peaks of two years ago but are set to pick up again and are unlikely to drop back to their average levels of the past decade, according to the annual joint report from Paris-based thinktank the OECD and the UN Food and Agriculture Organisation (FAO).

The forecasts are for wheat and coarse grain prices over the next 10 years to be between 15% and 40% higher in real terms, once adjusted for inflation, than their average levels during the 1997-2006 period, the decade before the price spike of 2007-08. Real prices for vegetable oils are expected to be more than 40% higher and dairy prices are projected to be between 16-45% higher. But rises in livestock prices are expected to be less marked, although world demand for meat is climbing faster than for other farm commodities on the back of rising wealth for some sections of the population in emerging economies.

Although the report sees production increasing to meet demand, it warns that recent price spikes and the economic crisis have contributed to a rise in hunger and food insecurity. About 1 billion people are now estimated to be undernourished, it said.

Fairtrade campaigners said the predictions of sharply rising prices provided a "stark warning" to international policymakers.

"Investment to encourage the 1 billion people whose livelihoods rely on smallholder agriculture is vital. Not only will this increase yields but will go a long way to increase prosperity in poverty stricken regions," said Barbara Crowther, director of communications at the Fairtrade Foundation.

"At the same time, the promise of increased agriculture commodity prices could spark a new surge in land grabbing by sovereign wealth funds and other powerful investors which risks marginalising further rural communities who must be included in solutions to secure and maintain food supplies."

The report says that agricultural production and productivity must be stepped up and it argues for a well-functioning trading system to ensure fair competition and that surplus food is getting to where it is needed.

It also painted a growing role for developing countries in both boosting demand and production. Brazil is by far the fastest growing agricultural producer, with output expected to rise by more than 40% in the next decade and production growth is also expected to be well above 20% in China, India, Russia and Ukraine.

"The role of developing countries in international markets is growing quickly, and as their impact grows, their policies also have an increasing bearing on conditions in global markets," said FAO director-general Jacques Diouf.

"This makes their role and contribution to global policy issues critical. Policy discussions must be global in scope and we need to improve the framework for such exchange of views."

Another factor driving up food prices is the controversial biofuels industry. The report predicts that continued expansion of biofuel output – often to meet government targets – will create additional demand for wheat, coarse grains, vegetable oils and sugar.

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Next Up? A Food Price Crisis

by Carolyn Cohn

LONDON -- A food price crisis may be the next stumbling block for emerging economies, even as their bonds and stock markets rally in relief at an easing of the euro zone's debt crisis.

Wheat prices have jumped by more than 50 percent since June and are likely to rise further due to expectations of tighter supplies, triggering concerns about a repeat of the food crisis in 2007/08 that forced interest rates higher in many economies and led to emergency controls in others.

The UN's Food and Agriculture Organisation (FAO) cut its 2010 global wheat forecast by about 4 percent this week and said world wheat supplies may shrink next year if severe drought continues in Russia, Europe's leading wheat producer.

Russia imposed a temporary export ban on Thursday in response to a record-breaking heatwave and the extent of the damage to crops and its economy is only beginning to become clear.

Spiralling wheat prices could translate into higher inflation and possibly higher interest rates in emerging market economies, which tend to hold a large proportion of their consumer price baskets in food.

The FAO said healthy world stock levels should prevent a repeat of the crisis of 2007/08 but past squeezes on food have led some central banks to hike aggressively in a bid to head off a second round of price rises in their economies.

Analysts and investors are already preparing for tighter monetary policy in emerging economies, even as they look to the possibility of further quantitative easing in the United States.

"It is a big deal for emerging markets, though maybe not as big a deal as it was in 2006/7/8, as food prices make up 20-50 percent of emerging CPI baskets," said Charles Robertson, EEMEA chief economist at ING.

"Food prices never move in the U.S. as a result of changes in global harvests, because so much of the price of food is taken up by packaging, suppliers. In the EU, food prices move a little bit but in emerging markets, food price rises can add a few percentage points to the inflation rate."

RUSSIAN RATES

Countries likely to be particularly at risk from high wheat prices include Nigeria, which has 25 percent of its CPI basket in bread and cereals, Robertson said.

Western economies typically have less than 20 percent of their CPI basket in food, compared with 30 percent on average in emerging markets, according to U.S. bank Morgan Stanley.

In Russia, higher wheat prices are contributing to speculation that the central bank will raise interest rates as early this year, after cutting 14 times since April 2009 to a record low refinancing rate of 7.75 percent.

Annual inflation in Russia is 5.5 percent.

"We see more upside risks...even a 15 percent inflation rate next summer does not seem unthinkable," said analysts at Danske in a client note.

Some central banks have already responded.

In India, a year-long spell of double-digit inflation, largely on rising food prices, sparked massive street protests.

One of a small but growing number of economies to have started raising interest rates, India has lifted its main lending rate four times by a total of 100 basis points since March, to 5.75 percent. Analysts say there is more to come.

However, an end to the El Nino weather pattern which led to the food price spike in India may actually reduce food price inflation in India, analysts say.

CURRENCY BOOST

Higher inflation and higher interest rates tend to depress bond prices and can also affect corporate lending, eroding stock market gains.

Investors have flocked into emerging market debt this year, keeping spreads below the key 300 basis point level over U.S. Treasuries, in their search for higher yield without exposure to even riskier emerging equities. Any whiff of inflation is likely to turn those debt investors more cautious.

But currencies find an upside in higher rates, due to the relative appeal of holding deposits in higher-yielding markets.

The Ukrainian hryvnia, which has already shown some appreciation in recent months due to an improving economy, is singled out by analysts as likely to rise further.

The rouble may also be allowed to rise if Russia has to import grain, although Russian prime minister Vladimir Putin on Thursday imposed a temporary grain export ban.

"Countries that import food could be more open to allowing their currencies to appreciate in order to cope with higher food prices," said Elisabeth Gruie, emerging market strategist at BNP Paribas. "Eastern European countries such as Poland will be sensitive to the impact on higher food prices on inflation and could react by adjusting monetary policy."

Fuel and food prices took inflation to multi-year highs in central Europe in 2008, prompting rate rises, and there were also protests against rising food prices in many emerging market countries.

To grapple spiking food price inflation, several emerging food exporters, including Russia, Ukraine and Kazakhstan, introduced export duties in early 2008. Russia had already imposed price controls on basic foodstuffs in Oct 2007.

Wheat prices can also lead to higher prices of other food, as consumers switch to buying more rice, for example, putting upward pressure on currencies in the Middle East and Asia.

"Places like Egypt, India, Indonesia and the Philippines are pretty big importers of food," said Philip Poole, head of macro and investment strategy at HSBC Global Asset Management.

"Consumers are moving up the food chain in emerging markets, literally, that's putting the pressure on."

Additional reporting by Sebastian Tong; editing by Patrick Graham