Food & Marketing

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Food Prices To Maintain Slow Rise In 1998

The Consumer Price Index (CPI) for food in 1998 is forecast to rise 2.5-3 percent, below the 3.3-percent increase in 1996 but close to the 2.8-percent rise forecast for 1997. The at-home component of the CPI, which increased 3.7 percent in 1996, is forecast to increase 2.5 percent in 1997 and 2.5-3 percent in 1998. The away-from-home component of the CPI, which increased 2.5 percent in 1996, is expected to increase 2.9 percent in 1997 and 2.5-3 percent in 1998.

The higher Federal minimum wage, which went into effect in fall 1996, had only a small effect on the away-from-home index in 1996, but placed some upward pressure on prices in early 1997. Another increase on September 1, 1997 of 40 cents per hour in the Federal minimum wage may place additional pressure on away-from-home prices through next year.

Competition among restaurants and fast-food establishments remained strong in 1997 and held down the full pass-through of higher wage and raw materials costs to consumers, but additional pass-through may occur in 1998. At-home food price increases have been moderated by lower grain prices, adequate supplies of fresh fruits and vegetables, increased sugar production, and strong competition in the soft drink and prepared foods industries.

The CPI for food remained relatively flat during the first 8 months of 1997, with month-to-month increases of only 0.1 percent in both January and March, 0.3 percent in July, and 0.4 percent in August. February, April, May, and June saw no increases in the all-food price index. If these small monthly increases were annualized for 1997, food inflation would be around 1 percent for the entire year, but the month-to-month index increases for the first half of 1997 followed strong increases in the last half of 1996. For the first 8 months of 1997, the price index for all food increased 3 percent. The all-food index is forecast to increase 2.5 percent in the remaining 4 months of 1997, for an annual increase of 2.8 percent.

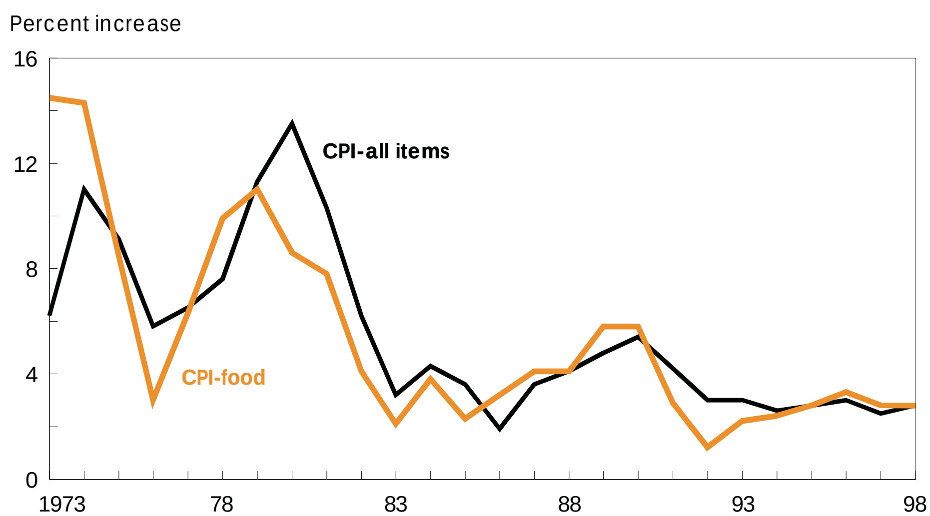
Food prices are among the most volatile consumer goods tracked by Federal agencies. General economic factors as well as the relationship between farm and marketing costs influence retail food price changes. Since 1992, food prices have held to fairly stable gains of 3 percent annually.

Four major trends account for this stability and are expected to continue to moderate price increases in 1997 and 1998.

General inflationary pressure has remained stable at about 3 percent, with expected increases in 1997 and 1998 of 2.5 and 2.8 percent, keeping in check the costs of food production as well as marketing costs—e.g., labor, packaging, transportation, and advertising—which together account for over 75 percent of retail food costs. Because *the farm value proportion of the U.S. food dollar has generally been declining*—expected to average about 22 cents in 1997 and 1998—retail prices are determined less by farm commodity prices and more by these food production and marketing costs. At the same time, *increasing economies of size in the agricultural sector* are expected to continue, particularly in the livestock and poultry industries, leading to slower growth in per-unit production costs.

Finally, *continued growth in the portion of the food dollar spent on food away from home* brings food prices more under the influence of developments in the nonfarm economy and of competition among restaurants and fast-food establishments. Currently, those influences are slowing the pace of food price increases. Growing numbers of two-income households, with

Rises in Food Prices and Overall CPI to Converge



1997 and 1998 forecasts (1998 is midpoint of forecast range).
Sources: Bureau of Labor Statistics, U.S. Department of Labor; 1997 and 1998 forecasts, Economic Research Service.
Economic Research Service, USDA

less time to prepare food at home and more income to purchase food away from home, have resulted in faster growth in purchases of food away from home than in purchases for home consumption. Away-from-home purchases are expected to account for 46-47 percent of total food dollars spent in 1997 and 1998.

Price forecasts by USDA's Economic Research Service for food consumed at home—the at-home food CPI—cover meats, poultry, fish and seafood, eggs, dairy products, fats and oils, fruits and vegetables, sugar and sweets, cereals and bakery products, nonalcoholic beverages, and other prepared foods.

Total *meat* production is expected to increase about 4 percent in 1998, compared with 1 percent this year. Next year's increase is based on recovery in pork production and continued expansion in the poultry industry. The CPI for meats is forecast to rise 2-4 percent in 1998, compared with about a 3-percent rise in 1997.

In terms of value, *beef* remains the largest single meat item purchased for at-home consumption, due to its normally higher price per pound. Although poultry has surpassed beef in total production and pounds-per-capita consumption, beef accounts for 9.5 percent of the at-home retail food dollar while poultry accounts for only 4.5 percent.

Beef prices are expected to increase 2-4 percent in 1998, following an increase of just over 2 percent expected in 1997. Beef supplies in 1998 are expected to decline, with 1998 production projected down nearly 2 percent from the output of 25.3 billion pounds forecast for 1997. Cattle inventories are beginning to stabilize and shift toward expansion, but the shift is likely to be slow and will not be fully implemented at least until 1999.

The CPI for *pork*, which accounts for over 6 percent of the at-home food dollar, is expected to rise over 5 percent in 1997, compared with a 9.9-percent gain in 1996. The 1998 forecast calls for an even smaller (0-2 percent) increase. Pork production is expected to rise 8 percent in 1998, with demand for bacon in the fast-food industry expected to continue. In 1998, production gains are expected to be partially offset by an increase in exports, about 10 percent higher than 1997 levels, with Japan likely to be the main buyer.

The 1997 food price index for *poultry*, 4.5 percent of the at-home CPI, is expected to increase about 2.5 percent, followed by a 2-4 percent increase in 1998. With demand still booming and feed costs about 15 percent lower in 1997, broiler production is forecast to total about 27.2 billion pounds this year, up 4 percent over 1996, and is expected to grow another 6-7 percent in 1998 to around 29 billion pounds.

Fish and seafood account for less than 4 percent of the at-home food CPI. Prices for major fish items increased slightly in 1997, after remaining flat in 1996. The CPI for fish and seafood is expected to register an increase of 2.9 percent for 1997, followed by a 2-4-percent rise in 1998.

Retail *egg* prices have been fairly stable in 1997, compared with last year's volatile retail prices. The CPI for eggs, less than 2 percent of the at-home food dollar, is expected to be down 1.4 percent for 1997, after increasing 18 percent in 1996. A rebound in egg prices is expected in 1998, pointing to a forecast CPI increase of 6-8 percent.

Dairy products account for over 12 percent of the at-home CPI. Lower prices for milk, cheese, butter, and ice cream have combined to produce a smaller CPI increase for dairy products in 1997—1.9 percent—compared with the 7-percent increase of 1996. Total 1997 milk production is expected to be up about 1 percent from a year earlier, and 1998 production is also expected to grow moderately. As milk production has increased, 1997 retail price increases have been smaller than the 1996 price gain. With moderate production growth expected in 1998, the dairy products CPI is forecast to increase 1-3 percent.

Eggs, Fresh Fruits and Vegetables to Show Largest Price Increases

Consumer Price Index	Relative weights*	1996	Forecast 1997	Forecast 1998
	Percent		Percent change	
All items		3.0	2.5	2.8
All food	100.0	3.3	2.8	2.5 to 3
Food away from home	36.9	2.5	2.9	2.5 to 3
Food at home	63.1	3.7	2.5	2.5 to 3
Meats	12.4	3.5	3.1	2 to 4
Beef and veal	6.0	-0.3	2.1	2 to 4
Pork	3.9	9.9	5.2	0 to 2
Other meats	2.5	3.6	2.6	1 to 3
Poultry	2.9	6.2	2.5	2 to 4
Fish and seafood	2.4	0.9	2.9	2 to 4
Eggs	1.3	18.0	-1.4	6 to 8
Dairy products	7.8	7.0	1.9	1 to 3
Fats and oils	1.5	2.4	1.0	1 to 3
Fruits and vegetables	12.4	3.5	1.1	3 to 5
Fresh fruits and vegetables	8.5	2.8	0.4	3 to 5
Fresh fruits	5.0	7.1	0	3 to 5
Fresh vegetables	3.6	-2.0	0.8	3 to 5
Processed fruits and vegetables	3.9	5.0	2.7	2 to 4
Processed fruits	2.2	5.8	2.8	2 to 4
Processed vegetables	1.7	4.0	2.6	1 to 3
Sugar and sweets	2.1	4.5	2.9	2 to 4
Cereals and bakery products	9.3	3.9	2.2	2 to 4
Nonalcoholic beverages	4.5	-2.4	7.7	2 to 4
Other prepared foods	6.5	3.4	3.6	2 to 4

*Bureau of Labor Statistics estimated weights—expenditure shares—as share of all food, December 1996.
Sources: Historical data, Bureau of Labor Statistics; forecasts, Economic Research Service.
Economic Research Service, USDA

Food & Marketing

Price change for *fats and oils*, both highly processed foods, are influenced more by the general inflation rate than by the cost of the raw commodities from which they are produced. The CPI for fats and oils, which account for only 2.5 percent of the at-home CPI, is expected to increase less than the general inflation rate, 1 percent in 1997 and 1-3 percent in 1998.

Fresh fruits and vegetables account for a combined 13.5 percent of the at-home food CPI, while *processed fruits and vegetables* account for about 6 percent. Retail prices for a number of fresh fruits and vegetables are flat or lower this year, responding to adequate supplies of major items. No change is expected in the *fresh fruit* CPI in 1997, following a 7.1-percent increase in 1996. The *fresh vegetable* index is expected to increase by a slight 0.8 percent this year, after falling 2 percent in 1996. In 1998, both the fresh fruit and the fresh vegetable food price indices are expected to rise 3-5 percent.

Summer fruits were in abundant supply in 1997, bringing about generally lower prices and expanded export opportunities for the U.S. fruit industry. California, the largest producer of peaches in the U.S., is expected to produce another large crop in 1997. Supplies of nectarines, plums, apricots, and sweet cherries were abundant in 1997. California's 1996/97 orange and grapefruit production, sold mainly for fresh use, was larger than the previous year. Three countries—Mexico, China, and Chile—have agreed to open their markets to specific U.S. fruits beginning in 1997, which may boost demand and prices.

With stable grower prices for *fresh-market vegetables*, overall summer 1997 acreage was about the same as the year before. In spite of a January freeze in Florida and direct crop losses from heavy spring rains in Texas, consumers saw only small increases in retail prices for fresh vegetables and melons in 1997. The relatively stable price pattern for fresh vegetables is expected to continue into fall 1997. The overall fresh vegetable CPI decline in 1996 and very small increase in 1997 are due partly to low prices for potatoes. However, the possibility of a serious potato blight in Idaho may significantly reduce potato production in 1997 and start moving consumer prices upward in 1998.

Contract acreage for the five leading *processing vegetables* (tomatoes, sweet corn, snap beans, green peas, and cucumbers) was down 3 percent, to 1.35 million acres in 1997. This drop came after a 9-percent decline in planted acreage a year earlier. However, processed vegetable prices are expected to increase only a modest 2.6 percent in 1997 and 1-3 percent in 1998. The ready availability of fruit supplies to meet processing needs is keeping the expected CPI increase for *processed fruits* to 2.8 percent in 1997 and 2-4 percent in 1998.

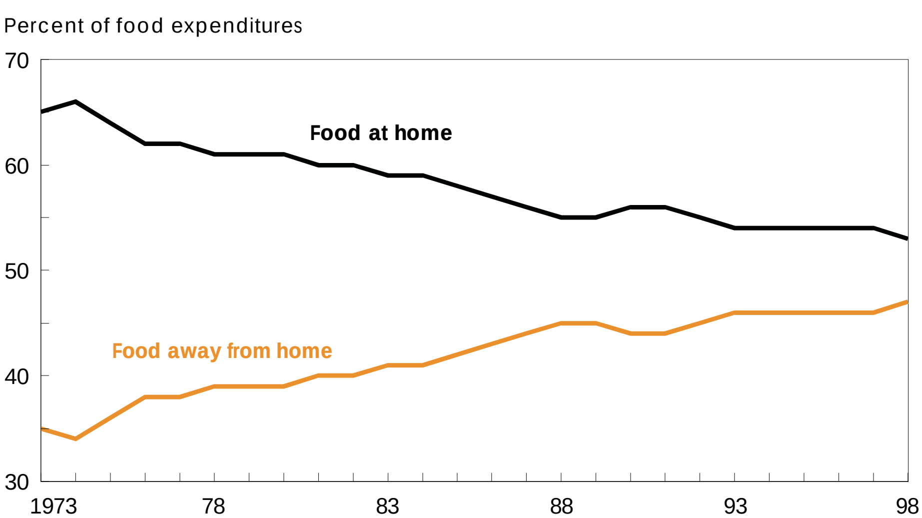
The CPI for *sugar and sweets*—3.3 percent of the at-home CPI—is expected to advance 2.9 percent in 1997, with gains of 2-4 percent in 1998. Domestic sugar production is expected to increase 3.4 percent in 1997, keeping the price increase to a modest 2-4 percent in 1998. Sugar beet acreage was up 7 percent in 1997, the result of lower returns to alternative crops, relatively strong sugar prices earlier in 1997, and increases in factory beet slicing capacity (*AO* July 1997).

Cereals and bakery products account for the largest single portion of the at-home food CPI—almost 15 percent. While stronger grain prices led to higher prices for selected bakery products in 1996 and a CPI increase of 3.9 percent, lower grain prices this year have held the increase to 2.2 percent. In 1998, cereals and bakery products are expected to increase 2-4 percent. Cereal prices, which account for a fifth of the cereals and bakery products index, fell 1.2 percent in 1996, and in the first 8 months of 1997 have fallen an additional 2.8 percent compared with the first 8 months of 1996.

Since only a small portion—less than 10 percent—of the retail price for most processed food items stems from the cost of ingredients—including flour, sugar, and oil—most of the retail price changes are the result of general inflation and competition. Competition for market share among the three leading breakfast cereal manufacturers led to retail price cuts in 1996. A recent announcement of cereal price increases by a leading manufacturer has not yet led to any significant monthly price increases in 1997.

Nonalcoholic beverages account for over 7 percent of the at-home food CPI, with coffee and carbonated beverages the two major components—32 and 50 percent of the nonalcoholic beverages index. The nonalcoholic beverage CPI fell 2.4 percent in 1996 due to lower coffee prices, and is expected to increase 7.7 percent in

Food Away From Home Accounts for Growing Portion of Food Dollar



997 and 1998 forecasts (1998 is midpoint of CPI forecast range).
Sources: Bureau of Labor Statistics, U.S. Department of Labor; 1997 and 1998 forecasts, Economic Research Service.

Economic Research Service, USDA

What's Behind the Numbers?

Food price forecasts by USDA's Economic Research Service (ERS) are developed through a three-step process. Analysts begin with USDA's 10-year baseline projections. The baseline, published annually in February, is the product of model results and the judgments of analysts from several USDA agencies. The baseline is based on a conditional scenario with specific assumptions regarding the macroeconomy, weather, and international developments (*AO* April 1997). No economic shocks are assumed in baseline projections.

In the second step, ERS analysts develop short-term forecasts (12-18 months) that incorporate the most recent baseline assumptions and current information on market conditions and expectations, weather patterns, commodity prices and supplies, and expected consumer demand for specific foods. Finally, these short-term forecasts are checked using a computer model (ARIMA forecast), which determines whether the ERS short-term forecast falls within an expected statistical range limit (a 95-percent confidence level).

Food price forecasts for 1997 and 1998, developed using this three-step process, may still be revised if the conditions on which they are based should change significantly. Projections could be affected if changes occur, for example, in the feed grain crop outlook; in the export market, especially for meat items; in nonfarm markets; or in weather-related crop conditions in major fresh fruit and vegetable growing areas. Historical retail price data indicate fresh fruit and vegetable prices and egg prices are the most volatile food prices ERS tracks.

Historical data also indicate grain price changes have affected the price of meats, poultry, eggs, dairy products, and cereals and bakery products. Since these items account for more than half of the at-home food dollar, price changes for these categories can have a significant impact on the at-home food CPI.

1997 in the wake of higher coffee prices. During the first 8 months of 1997, retail coffee prices were up 9 percent from the same period last year. Carbonated drinks, on the other hand, fell 1.4 percent in the first 8 months of 1997, compared with the same period in 1996, due to competition in the soft drink industry during peak consumption months. In 1998, the nonalcoholic index is forecast to return to a trend increase of 2-4 percent.

Speculation about a lower 1997/98 coffee crop in Brazil (the largest Arabica coffee producer) and an uncertain labor situation in Colombia were responsible for the sharp increases in green coffee costs (mostly for Arabica used primarily in gourmet coffee blends) on the world market in spring and summer 1997. These price increases combined with low U.S. and Mexican coffee stocks to produce wholesale price fluctuations that led to higher retail prices.

However, prices of Robusta coffee beans, the primary ingredient in retail store coffee blends, have not increased as sharply as Arabica prices. Since the CPI for coffee reflects only coffee purchased in retail stores, smaller increases in Robusta prices have held down what might have been an even larger increase in the nonalcoholic beverages price index.

Other miscellaneous prepared foods, accounting for over 10 percent of the at-home food CPI, are highly processed and are affected primarily by changes in the all-items CPI. These products include frozen dinners, pizzas, and precooked frozen meats. Competition among these products and from the away-from-home food market should continue to dampen retail price increases for this category of items. An increase of 3.6 percent in the CPI for the category is expected in 1997, followed by 2-4 percent in 1998.

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