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## THE 1989 OUTLOOK FOR FOOD PRICES

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The Consumer Price Index (CPI) for food in 1988 has risen at near the same rate as it did in 1987, about 4 percent. A similar increase is expected in the CPI for all items which means that food prices in 1988 have kept pace with prices of other goods and services in the general economy. Consumers, however, are more aware of changes in food prices than in price changes of other goods and services because food is a basic necessity. Food is purchased more often than most other goods which also heightens consumer awareness of price changes. This year, heavy media coverage of the drought and the warning of eminent food price inflation raised consumer awareness even more.

Major factors influencing retail food prices are: farm prices, costs of processing and distributing food, and consumer demand. Farm prices for a number of commodities have increased this year. A combination of drought and strong consumer demand have pushed average farm prices for food commodities up 3.5 percent this year. Charges for processing and distributing food have also increased about 5 percent, mainly due to higher costs for packaging materials, transportation, and labor. The creation of new jobs and the resulting higher employment has led to an approximate 3 percent rise in real disposable personal income. Such a rise in real income supports higher consumer demand for food.

Factors affecting food prices have impacted different foods in different ways. Strong consumer demand has had a major impact on some foods while higher farm prices and higher processing costs have affected others. A discussion of the individual foods will help to explain how these factors have affected food this year and provide some insight as to what might be expected in 1989.

### Meats

Per capita consumption of total red meat and poultry will reach 220 pounds this year, the highest ever. While beef production for 1988 is down about 1 percent from last year, pork production is up about 7 percent and poultry production is up 5 percent. With larger supplies, retail pork prices have averaged slightly below the high levels of a year earlier, but have remained high relative to recent history. Despite larger supplies, poultry prices have increased, reflecting strong consumer demand. Heavy advertising and promotion campaigns during the summer for chicken items by fast food firms has helped to stimulate demand. This fall, retail pork and poultry prices have decreased as

supplies increased seasonally. For the year, retail beef prices are expected to average about 5 percent above 1987, retail pork prices will average about 3 percent below the high levels of last year, and poultry prices will average 5.5 percent above 1987.

In 1989, total red meat and poultry supplies will be second only to this year. Beef production is expected to decrease 6 to 8 percent from 1988. Pork production is likely to remain about level with this year. Poultry production is expected to increase 2 to 3 percent. Even though production will be down, beef prices next year are expected to be 1 to 3 percent above 1988. Pork prices will rise about the same as beef. Poultry prices are expected to decrease 4 to 7 percent as supplies continue to grow.

### Cereals and bakery products

The CPI for cereals and bakery products this year is expected to average 6.5 percent above 1987. There are several reasons for the strong increase. First, demand for cereal products has increased considerably in the past few years. Consumers are becoming more health-conscious and find cereals a good source of nutrition. Cereals are also easy to prepare. The proliferation of new cereals on grocery shelves, all claiming high fiber and other nutritional benefits, is strong evidence of the new health trend. Such strong demand puts upward pressure on prices.

Next, the cost of processing and distributing food has increased. Such costs account for about 90 percent of the retail price of cereals and bakery products. Most of the increase comes from a rise in the price of packaging materials. Prices of paper products, plastic wrap, and metal foil used in packaging cereal and bakery products have increased 17 percent, 13 percent, and 22 percent respectively. When passed through to the consumer, these increased packaging costs could add 1 percent to the CPI for cereals and bakery products.

Finally, farm prices of food grains have increased 50 to 60 percent this year. Most of the increase in grain prices was caused by smaller supplies resulting from the drought. The cost of grain in cereal and bakery products accounts for about 10 percent of the retail prices. Therefore, the rise in grain prices could theoretically add 5 to 6 percent to the retail price if passed through to consumers.

The CPI for cereals and bakery products in 1989 is expected to rise 4 to 7 percent above 1988. Strong consumer demand will continue to exert upward pressure on prices. A slightly higher rate of inflation in the general economy will push costs of processing and distributing food higher. Some lingering effects of the drought will be felt as grain price increases, which occurred this year, will continue to influence consumer prices in 1989.

### Fresh vegetables

The CPI for fresh vegetables in 1988 will average nearly 6 percent above 1987. In the first quarter of 1988, a disease affecting lettuce continued to plague production. Lettuce prices were record-high toward the end of 1987, and those high prices carried over into the first quarter of 1988. Lettuce has a strong influence on the total fresh vegetable CPI and the index rose more than would have been expected otherwise. The fresh vegetable CPI declined in the second quarter as the supply situation returned to more normal levels. During the third quarter, however, the impact of the drought pushed the index up at a

time when fresh vegetable prices normally show a seasonal decline. During the summer, fresh vegetables are supplied from local sources as well as the traditional irrigated commercial growing areas in California. In the broad area effected by the drought, local vegetable production was damaged and supplies had to shipped in from more distant sources, causing retail prices to increase.

Vegetable production for the fresh market will likely expand in 1989 because of strong grower prices this year. Barring a winter freeze in Florida or another summer drought, fresh vegetable prices are likely to remain relatively stable. The fresh vegetable CPI in 1989 is expected to show little change from 1988.

#### Processed vegetables

The major sources of peas, snap beans, and sweet corn for canning are in the upper midwest which was severely hit by the 1988 drought. The 1988 pack of these vegetables was reduced considerably. As a result, prices of canned vegetables have increased. While a specific price index for these items is not available, the information that is available suggests a rise of about 15 percent.

Supplies of canned vegetables will remain low for most of next year. Retail prices will likely continue to increase as stocks dwindle. Prices will likely level off as the new pack becomes available toward the end of next summer.

#### Fresh fruits

The CPI for fresh fruits rose nearly 8 percent this year. Apple production was particularly large last fall, and prices through most of this year have been below a year ago. Higher prices for other noncitrus fruits, however, reflect slightly smaller supplies this year. Banana imports have been below last year as some shipments were returned because of insect infestations. Also, labor disruptions in Colombia stopped banana shipments from that source.

Fresh fruit prices will likely rise again in 1989 from a combination of strong domestic demand and strong export demand. Orange production for fresh market will be larger but increased exports to Japan could dampen increases in domestic supplies, keeping prices strong. Apple prices will also be higher as this season's crop is smaller than last year's. The CPI for fresh fruit is expected to rise at about the same rate in 1989 as in 1988.

#### Processed fruit

The CPI for processed fruit increased more than 10 percent in 1988. Higher prices for frozen concentrated orange juice (FCOJ) were the primary cause. Domestic production of FCOJ must be supplemented by imports from Brazil in order to meet domestic demand. Higher Brazilian FCOJ prices have caused domestic retail prices to rise this year.

Increased orange production this season and the resulting larger supplies of FCOJ will limit the need to import. As a result, FCOJ prices likely will remain stable in 1989.



## Dairy products

The CPI for dairy products has increased about 2 percent this year. Fresh milk and cream prices have risen about 2 percent. Cheese prices have increased about 4.5 percent above a year ago while ice cream and butter prices have remained level this year. The small rise in the dairy CPI dampens increases among the other food categories.

In 1989, the CPI for dairy products will rise at a slightly higher rate than in 1988. Export demand for nonfat dairy products will boost prices. Prices of manufactured dairy products will be affected by higher processing and distribution costs. The CPI for dairy products in 1989 is expected to rise 2 to 4 percent above 1988.

## Eggs

The CPI for eggs has risen a little over 5 percent this year. Higher feed grain prices resulting from the drought has caused producers to cut back on production. In addition, use of eggs in processing increased, further reducing supplies of cartoned table eggs. As a result, egg prices increased sharply in the third quarter. Egg prices are expected to remain high for the last quarter of 1988 because of strong export demand.

Retail prices for eggs will continue to rise in 1989. Production is expected to decrease reflecting poor returns to producers. Retail prices of eggs in 1989 will average 15 to 20 percent above 1988.

## Fats and oils

The major products in the fats and oils category of the food CPI are, salad and cooking oils, margarine, and peanut butter. The major farm commodities that effect these products are soybeans and peanuts. The 1988 peanut crop was larger than a year ago and farm prices have not increased. The soybean crop was hurt by the drought and soybean oil prices increased during the summer in anticipation of smaller supplies. Vegetable oil supplies, however, have been ample world wide and spot market prices for soybean oil have returned to their predrought levels. Nevertheless, retail prices of margarine, salad oils, and cooking oils have increased 5 to 8 percent in response to higher soybean oil prices that manufacturers faced during the summer. Peanut butter prices have remained level over the year and have dampened the increase in the total fats and oils index.

In 1989, the CPI for fats and oils is expected to rise at near the same rate as in 1988. Supplies of vegetable oils are ample and will likely remain so through next year. Strong demand and increased processing and marketing costs will be responsible for price increases next year.

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Changes in Food Price Indicators, 1986 through 1989

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	1986	1987	1988p	1989f
Consumer Price Indexes	Percent Change			
All food	3.2	4.1	4.0	3 to 5
Food away from home	3.9	4.0	3.9	4 to 6
Food at home	2.9	4.3	4.0	3 to 5
Meat, poultry and fish	4.3	6.4	3.2	0 to 3
Meat	3.2	7.1	2.0	1 to 3
Beef and veal	0.6	7.6	4.9	1 to 3
Pork	8.2	8.2	-2.9	1 to 4
Poultry	7.5	-1.5	6.6	-4 to -7
Fish and seafood	9.2	10.6	6.1	4 to 7
Eggs	6.9	-5.9	5.2	15 to 20
Dairy products	0.2	2.5	2.0	2 to 4
Fats and oils	-2.2	1.5	4.1	3 to 6
Fruits and vegetables	0.9	8.8	7.3	3 to 6
Fresh fruits	2.1	11.3	7.8	6 to 9
Fresh vegetables	4.0	12.9	5.8	0 to 3
Processed fruits and vegetables	-1.6	3.5	8.1	4 to 7
Processed fruits	-2.9	4.1	10.6	4 to 7
Processed vegetables	-0.2	2.7	4.7	4 to 7
Sugar and sweets	3.2	1.8	2.7	4 to 7
Cereals and bakery products	2.8	3.5	6.4	4 to 7
Nonalcoholic beverages	5.9	-2.6	0.0	4 to 7
Other prepared foods	2.6	4.2	3.6	3 to 5

p=preliminary f=forecast

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#### Market Basket Statistics

The market basket statistics represent the retail cost, the farm value, and the farm-to-retail price spread for a fixed market basket of domestically produced farm foods. The farm value of food and the farm to retail price spread help us understand the underlying causes of food price changes. The farm value of food accounts for about 30 percent of the retail and depicts that part of the consumer food dollar which goes to farmers. The farm-to-retail price spread represents that part of the consumer food dollar which goes for processing and distributing foods from the farm gate through the retail store.



The retail cost of the market basket is expected to increase 4.4 percent for 1988. The rate of increase is greater than that of the CPI for food, but the market basket does not include nonalcoholic beverages. The CPI for nonalcoholic beverages has not changed this year, and therefore, has moderated the rise in the CPI for all food. Contributing to the market basket increase was a 3.7 percent rise in the farm value of food, and a 4.8 percent increase in the farm-to-retail price spread.

The 3.7 percent rise in the farm value of food came primarily from higher farm prices for food grains resulting from the drought, and higher poultry prices resulting from strong demand. Lower prices for hogs and milk this year lowered the farm value for meats and dairy which partially offset higher farm values of other food groups.

The farm to retail price spread has risen 4.8 percent this year. The spread accounts for the costs of processing and distributing foods which we call marketing costs. The major inputs are, labor, packaging, transportation, and energy and account for 85 percent of all marketing costs. Our marketing cost index, which measures changes in prices of inputs, increased 3 percent this year. While prices of inputs increased, so did the volume of inputs. The number of workers has increased, particularly at the retail level. The addition of instore services such as deli services and salad bars require additional workers. Increased use of packaging materials are needed to accommodate the many new products available in the cereals and prepared foods categories. The increased use of marketing inputs along with higher prices for inputs have added significantly to the farm-to-retail price spread.

In 1989 we expect the spread to rise at near the same level as 1988. The farm value of food is expected to increase as farm prices of cattle, eggs, milk, grains, and fresh fruits rise.

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Percent Changes in Market Basket Statistics

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	1986	1987	1988p	1989f
Retail cost	2.1	5.0	4.4	3 to 5
Farm-to-retail spread	3.7	6.2	4.8	3 to 5
Farm value	-1.4	2.3	3.7	2 to 4

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p-preliminary f-forecast

#### Summary

The CPI for food in 1989 will increase at about the same rate as it did in 1988. Prices for eggs, fruits and vegetables, and cereal and bakery product will have the strongest impact on the increase. Prices for meats and poultry will dampen the increase. Strong consumer demand in 1989, prompted by increased disposable personal income, will have a positive impact on food prices as well. The effect of the 1988 drought on the food CPI in 1989 will be too small to measure, after having added about 0.5 percent in 1988.