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THE OUTLOOK FOR FOOD PRICES IN 2005

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Lead by trade disruptions due to Bovine Spongiform Encephalopathy (BSE) cases in both the U.S. and Canada, large increases in the farm price of milk, and weather related damage to some fruit and vegetable crops, 2004 saw retail food prices increase at the fastest rate since 1990. These unexpected shocks to the food supply system along with a recovering economy and increased energy prices were the main causes of the larger than expected increase in food prices. Nevertheless, retail food prices, as measured by the CPI for food increased 3.4 percent- less than one percent higher than the 2.5 percent average of the previous ten years (1994-2003). Continued strong competition in the retail food market kept food prices relatively stable overall in what was a turbulent year.

Traditional food retailers continue to vie with discount supercenters, club warehouse stores, dollar stores, convenience stores, and drug stores that are increasingly offering a larger array of food products to their price sensitive and time-pressed customers. These non-traditional retail outlets have increased their share of consumer food-at-home expenditures from 17.7% in 1998 to 30.8% in 2003, while traditional retailer expenditure shares declined from 82.3% in 1998 to 69.2% in 2003.

Within the non-traditional retail group, supercenters have experienced the largest increase over this 6 year period, increasing from just over 3% in 1998 to nearly 11% in 2003. Warehouse Club Stores and Dollar Stores have also experienced significant increases in their share of the consumer food dollar as time-crunched and deal-seeking U.S. consumers look to find the best combination of prices and services at their retailer of choice. With average food prices 15% to 25% lower at non-traditional retailers, traditional retailers have been forced to lower prices and/or increase the quality and variety of the services they provide in order to remain competitive. Additionally, traditional food retailers face greater competition from restaurants and other food away from home market options for consumers' food dollars.

Assuming no additional shocks to the food supply system, these retail market trends will work to keep prices fairly stable in 2005 as price inflation is projected to end up below the 2004 inflation levels. The CPI for all food is forecast to increase 2.5 to 3.5 percent in 2005, as the existing trends in retail food markets will be partially offset by increased energy and operating costs to put food price inflation below 2004 levels, and fairly steady over the next year.

Food Away From Home

The CPI for food away from home increased 3.0 percent in 2004 which was the highest increase in this category since 1991. Nevertheless, price inflation for food away from home was significantly lower than that of food at home (3.0 vs. 3.8) and this may imply some additional

inflation for this category in early 2005 as restaurants and other food service establishments adjust to higher food supply costs. However, since 2003 saw the lowest inflation measure in 10 years, it was not too surprising to have a higher than average increase in 2004. With a continued improving economy in 2005, consumers will be increasing their demand for food away from home and that should push prices up an additional 2.5 to 3.5 percent this year similar to the 2004 change.

Food at Home

Food-at-home prices increased 3.8 percent in 2004 which was the highest one-year increase since 1990. Forecasts for 2005 predict slightly lower inflation levels in the range of 2.5 to 3.5 percent. While the overall health of the U.S. economy affects food prices to a certain extent, the dynamics of competition in retail food markets have kept retail food prices fairly steady over the past few years. Even with the relatively high inflation of 2004, food-at-home prices average just a 2.6 percent increase per year over the past 10 years (1995-2004).

In summarizing 2004 food-at-home price increases, the big changes occurred in the beef, dairy, poultry, fats and oils, and egg categories. Beef prices increased an additional 11.6 percent following a 9.0 percent increase in 2003. Dairy prices were up 7.3 percent, the largest increase since 1990, and although egg prices fell from their all-time highs earlier in the year, they still ended up 6.2 percent higher in 2004. The following discussion highlights 2004 prices and focuses on expected CPI changes for 2005:

Meats. U.S. meat and poultry production is expected to increase 3.4 percent in 2005 after a slight decrease in 2004. Along these lines, beef production which fell 6.4 percent in 2004 is expected to increase 6.1 percent, while poultry and pork production which were up 2.9 and 2.8 percent, respectively in 2004, are expected to increase 3.0 and 0.1 percent, respectively, in 2005. Given the increased projected production, retail prices will be more stable in 2004 and are currently forecast to increase 0.0 to 1.0 percent in 2005.

Beef and Veal. The CPI for beef and veal rose 11.6 percent in 2004, but is expected to increase only 1.0 to 2.0 percent in 2005. The large increase in beef prices in 2004 was attributed to relatively tight supplies of domestic beef cattle, continued strong demand by consumers for beef, and price increases from meat suppliers in response to the BSE findings in the U.S. and Canada and the subsequent trade issues between the U.S. and its trading partners. This was the largest increase in any food category in 2004 and was the largest increase in beef prices since 1979.

Pork. The CPI for pork increased 5.6 percent in 2004 as producers looked to fill the gap left by beef and poultry food safety and trade concerns. The CPI for pork is expected to increase 1.0 to 2.0 percent in 2005 as more stable production and prices in other meat categories will keep pork prices down at the retail level.

Other meats increased 4.5 percent in 2004, and 2005 prices are expected to increase 1.0 to 2.0 percent. Other meats are highly processed food items (hot dogs,

bologna, sausages) with their price changes influenced by the general inflation rate as well as the cost of the meat inputs which should be more stable in 2005.

Poultry. The CPI for poultry increased 7.5 percent in 2004 (the largest one year increase since 1989), and an increase of 2.0 to 3.0 percent is expected in 2005. Broiler production in 2005 is forecast to increase by 3.1 percent, while turkey production is forecast to be up 2.4 percent.

Fish and seafood. The CPI for fish and seafood was up 2.3 percent in 2004, with an expected 2.0 to 3.0 percent increase in 2005. In the 1990's, U.S. per capita seafood consumption remained flat, between 14.8 and 15.2 pounds of edible meat per year, but over the past five years consumption has increased to over 16 pounds per year causing, along with the increased variety of fish products consumed, the increase in overall fish prices.

Eggs. Retail egg prices increased 6.2 percent in 2004, following a 13.8 percent increase in 2003. A combination of a slightly smaller laying flock, flat production and a strengthening economy pushed egg prices up to their highest levels in the history of the CPI in early 2004, but prices have dropped sharply since then and are forecast to decrease 3.0 to 4.0 percent in 2005.

Dairy and related products prices increased 7.3 percent in 2004 due mainly to relatively large increases in milk (12.1 percent) and cheese (6.7 percent) prices during the year. Increased competition among retailers had kept dairy prices relatively low when compared to other food products in 2002 and 2003, but this trend reversed itself in 2004, especially in terms of milk prices. The increase in farm milk prices in the first half of 2004 caused all-time high milk prices at the retail level during the middle of 2004. Dairy prices are forecast to increase 2.5 to 3.5 percent in 2005 as last year's milk price increases continue to work their way through the dairy food supply.

Fats and oils prices increased 6.6 percent in 2004 with soybean oil prices increasing early in the year and butter prices jumping 29.1 percent in 2004. The remaining items contained in the fats and oils index are highly processed food items, with their price changes influenced by the general inflation rate in addition to U.S. and world supplies of vegetable oils. Fats and oils prices are expected to increase 3.0 to 4.0 percent in 2005.

Fresh fruits. The CPI for fresh fruits increased 2.8 percent in 2004 and is expected to increase 3.0 to 4.0 percent in 2005, as retailers use the quality of produce as a selling point to attract customers and increase their market share. Fresh fruit prices were surprisingly stable during the first 9 months of 2004, but hurricane damage in Florida and elsewhere on the east coast caused prices to spike during the last 3 months of the year for some items, especially citrus fruit.

Fresh vegetables. The CPI for fresh vegetables increased 4.3 percent in 2004, and prices are expected to rise an additional 3.5 to 4.5 percent in 2005 due to continued strong demand for fresh vegetables. Given average weather, fresh vegetable supplies are

expected to remain at or above year earlier levels through the first quarter of 2005. The sharp price spike in tomatoes seen over the past few months dissipated at the end of 2004. As production returns to close-to-normal levels, tomato prices should begin to decrease at the retail level over the next few months.

Processed fruits and vegetables. The CPI for processed fruits and vegetables increased 1.3 percent in 2004 and is expected to increase 1.0 to 2.0 percent in 2005. Retailers will be hard-pressed to raise prices more than a modest amount in the coming year especially with increased availability and variety of fresh fruits and vegetables year-round.

Sugar and sweets. Although demand for sugar and sugar-related products continues to remain strong, lower retail prices for selected sugar-related products kept the 2004 CPI index increase for sugar and sweets to only 0.7 percent. In 2005, the CPI for sugar and sweets is expected to increase a moderate 0 to 1 percent. The sugar and sweets index has 3 sub-categories. They include sugar and artificial sweeteners which are 18.7 percent of the index and increased 0.8 percent in 2004; candy and chewing gum which are 60.6 percent of the index and increased 0.6 percent in 2004; and other sweets (jellies, jams, preserves, and syrups) which are 20.7 percent of the index and increased 1.4 percent in 2004.

Cereal and bakery products. The CPI for cereals and bakery products increased just 1.6 percent in 2004, as consumers seemed to be less inclined to purchase many grain products. With the popularity of low-carbohydrate diets on the decline, consumers will return to greater consumption of cereal and bakery products in 2005, including the many newly reformulated whole grain products. The CPI for cereal and bakery products is expected to increase 2.5 to 3.5 percent in 2005. This index has two sub-categories. They include cereals and cereal products which are 35 percent of the index and increased 0.5 percent in 2004; and bakery products which are 65 percent of the index and increased 2.1 percent in 2004. Most of the costs to produce cereal and bread products are for processing and marketing, more than 90 percent in most cases, leaving the farm ingredients as a minor cost consideration.

Nonalcoholic beverages. The CPI for nonalcoholic beverages increased 0.4 percent in 2004 and is forecast to increase 0.0 to 1.0 percent in 2005. Carbonated drinks, nonfrozen noncarbonated juices and drinks, and coffee are the three major components of this category, accounting for 39, 30, and 13 percent of the index. Retail prices were higher in 2004 for coffee (up 0.3 percent) and carbonated drinks (up 1.8 percent), while nonfrozen noncarbonated juices and drinks prices decreased 0.8 percent in 2004.

Other foods. The CPI for other foods increased 0.5 percent in 2004 and is forecast to increase 2.0 to 3.0 percent in 2005. Price trends for other foods—which includes soups, frozen and freeze-dried prepared foods, pizzas, snacks, spices, seasonings, sauces, and baby foods—are largely affected by changes in the pricing strategies of retailers looking to establish themselves as a low price destination for consumers looking for common packaged, usually branded, products. Competition within these product categories should continue to dampen retail price increases.

Looking ahead, food price inflation should stabilize in 2005 and will likely continue the historical decline in average annual food price inflation seen for most of the past 30 years. The 1970s, a relatively high inflation decade, had average annual food price inflation of 8.4 percent, while the 1980s saw food prices increase 4.6 percent, on average, per year. The current trend in food prices began in the 1990s which had average annual inflation of 2.8 percent. Current projections predict average annual food price inflation of 2.5 percent for the current decade.

**Changes in Retail Food Prices
2002 through 2005**

Item	Relative importance ¹	2002	2003	2004	Forecast 2005
		<i>Percent Change</i>			
Consumer Price Indexes	<i>Percent</i>	<i>Percent Change</i>			
All food	100.0	1.8	2.2	3.4	2.5 to 3.5
Food away from home	42.8	2.6	2.1	3.0	2.5 to 3.5
Food at home	57.2	1.3	2.2	3.8	2.5 to 3.5
Meats, poultry, and fish	15.2	0.5	4.0	7.4	0.0 to 1.0
Meats	10.2	0.6	5.4	8.4	1.0 to 2.0
Beef and Veal	5.1	0.1	9.0	11.6	1.0 to 2.0
Pork	3.1	-0.4	1.9	5.6	1.0 to 2.0
Other meats	2.0	3.5	2.5	4.5	1.5 to 2.5
Poultry	2.9	1.3	1.3	7.5	2.0 to 3.0
Fish and seafood	2.2	-1.6	1.0	2.3	2.0 to 3.0
Eggs	0.7	1.3	13.8	6.2	-4.0 to -3.0
Dairy products	5.9	0.6	-0.1	7.3	2.5 to 3.5
Fats and oils	1.8	-0.2	1.3	6.6	3.0 to 4.0
Fruits and vegetables	8.9	4.1	2.3	3.0	3.0 to 4.0
Fresh fruits & vegetables	7.2	4.2	2.7	3.5	3.5 to 4.5
Fresh fruits	3.5	1.9	3.3	2.8	3.0 to 4.0
Fresh vegetables	3.7	6.4	2.1	4.3	3.5 to 4.5
Processed fruits & vegetables	1.8	3.7	0.9	1.3	1.0 to 2.0
Sugar and sweets	2.1	2.1	1.9	0.7	0.0 to 1.0
Cereals and bakery products	8.3	2.2	2.4	1.6	2.5 to 3.5
Nonalcoholic beverages	6.2	0.0	0.4	0.4	0.0 to 1.0
Other foods	8.1	0.6	1.0	0.5	2.0 to 3.0

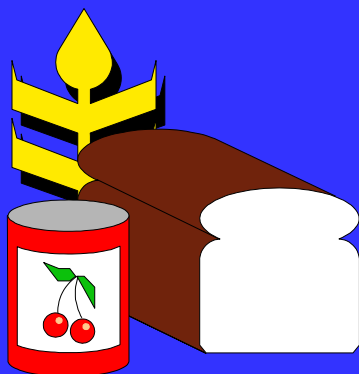
Source of historical data: Bureau of Labor Statistics; forecasts by Economic Research Service.
Contact: Ephraim Leibtag 202-694-5349, eleibtag@ers.usda.gov

¹ BLS estimated expenditure shares, December 2004.



2005 Retail Food Price Outlook

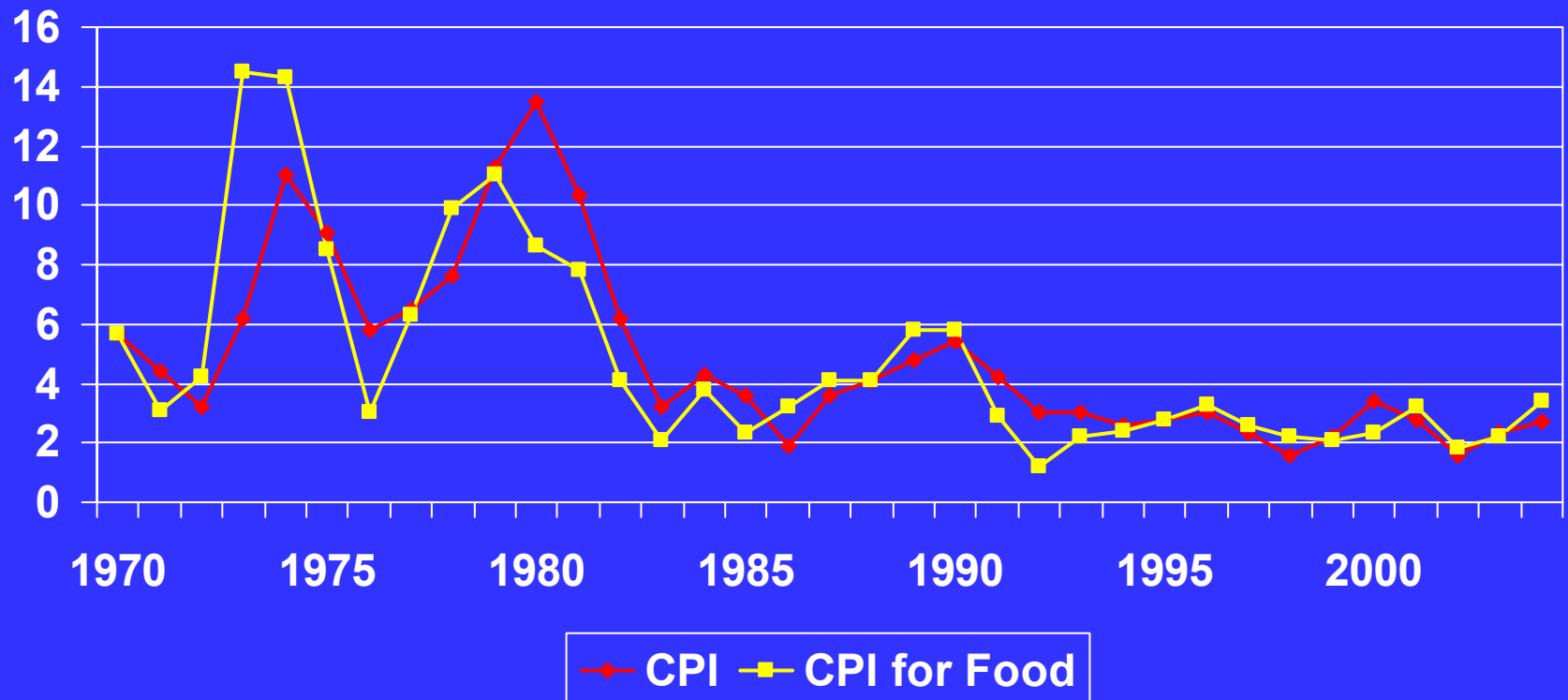
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CPI vs CPI for Food 1970-2004

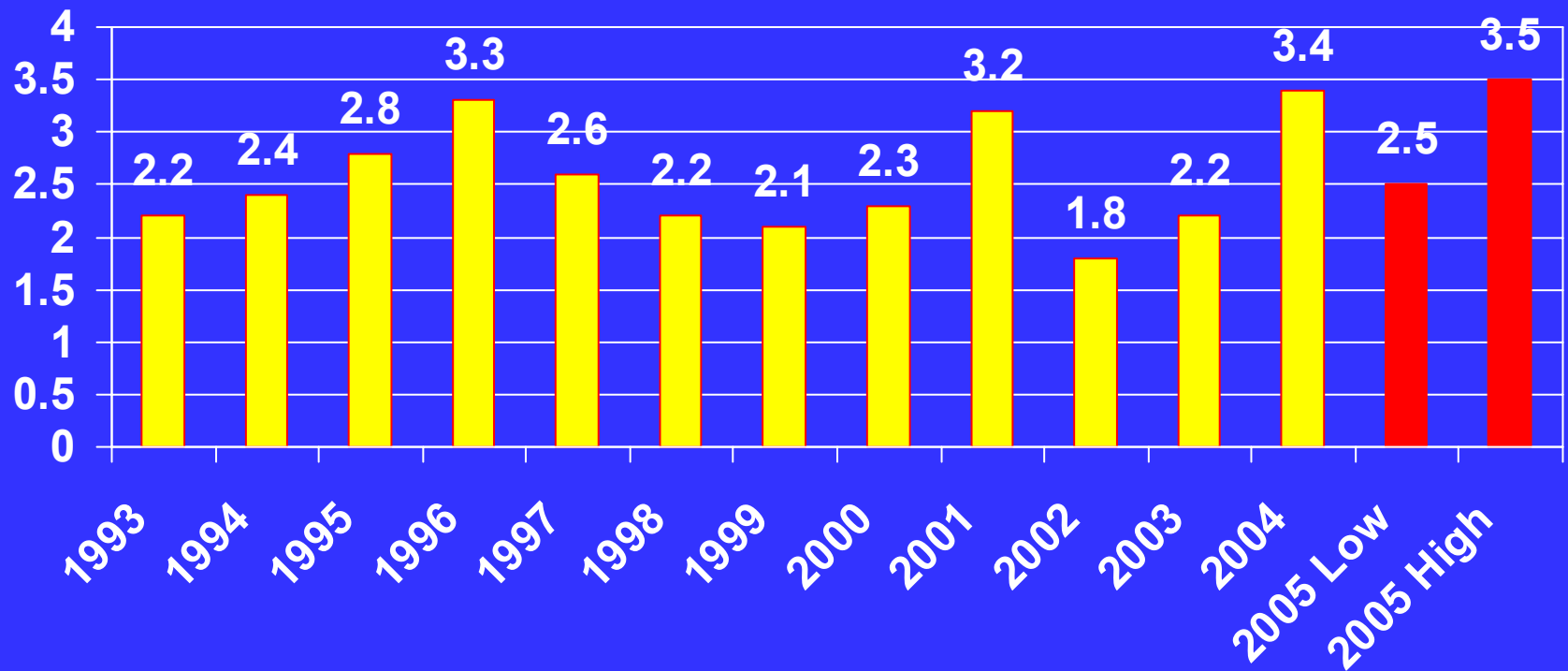
Annual Percent Change in CPI and CPI for Food



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CPI for Food Expected to Stabilize in 2005

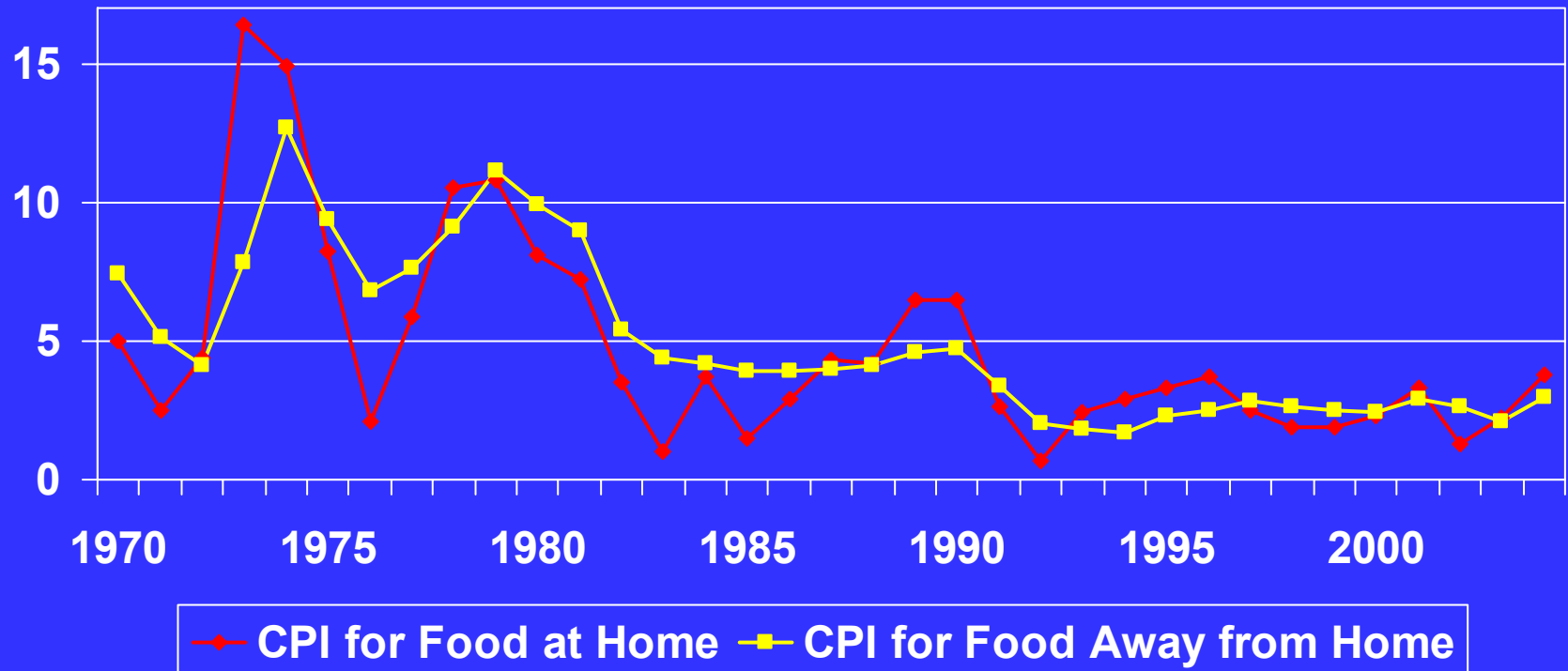
Annual Percent Change in CPI for Food



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Food at Home vs Food Away from Home 1970-2004

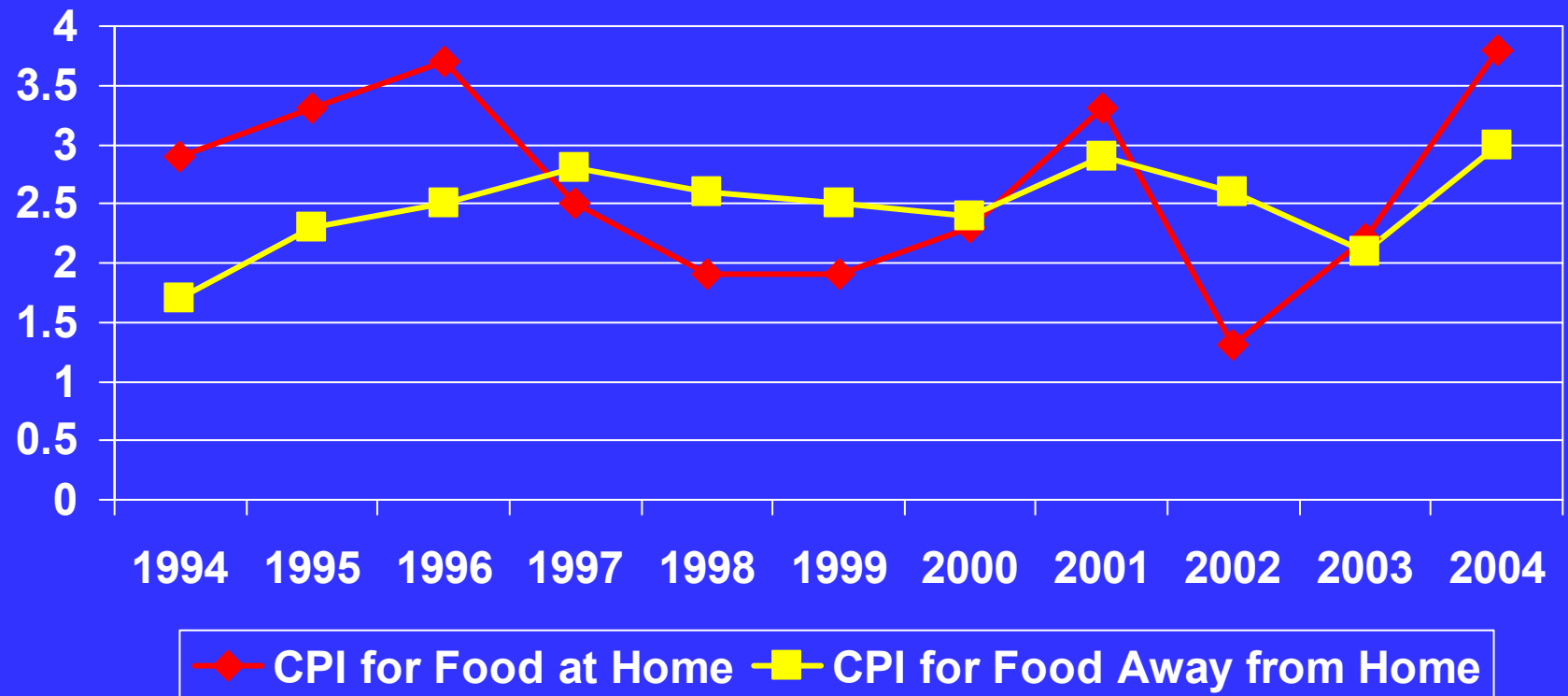
Annual Percent Change



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Food at Home vs Food Away from Home 1994-2004

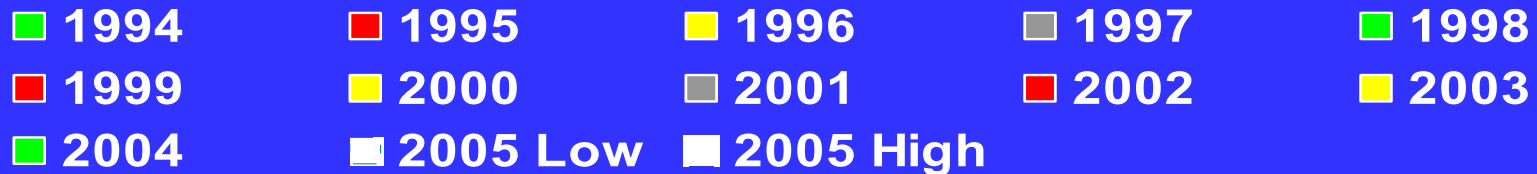
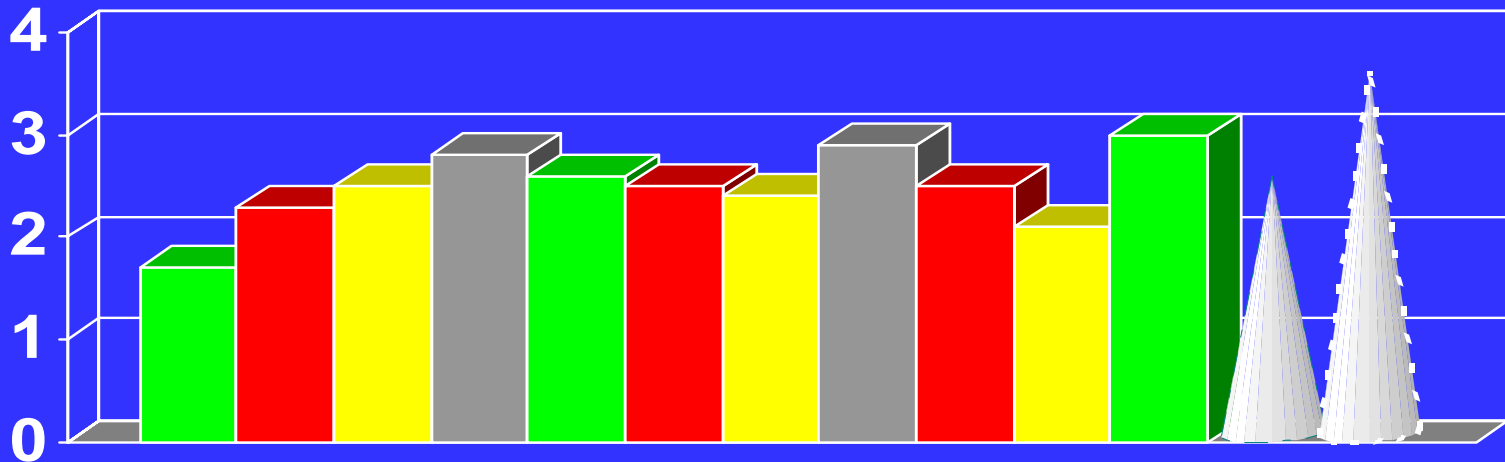
Annual Percent Change



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Steady Growth for FAFH CPI

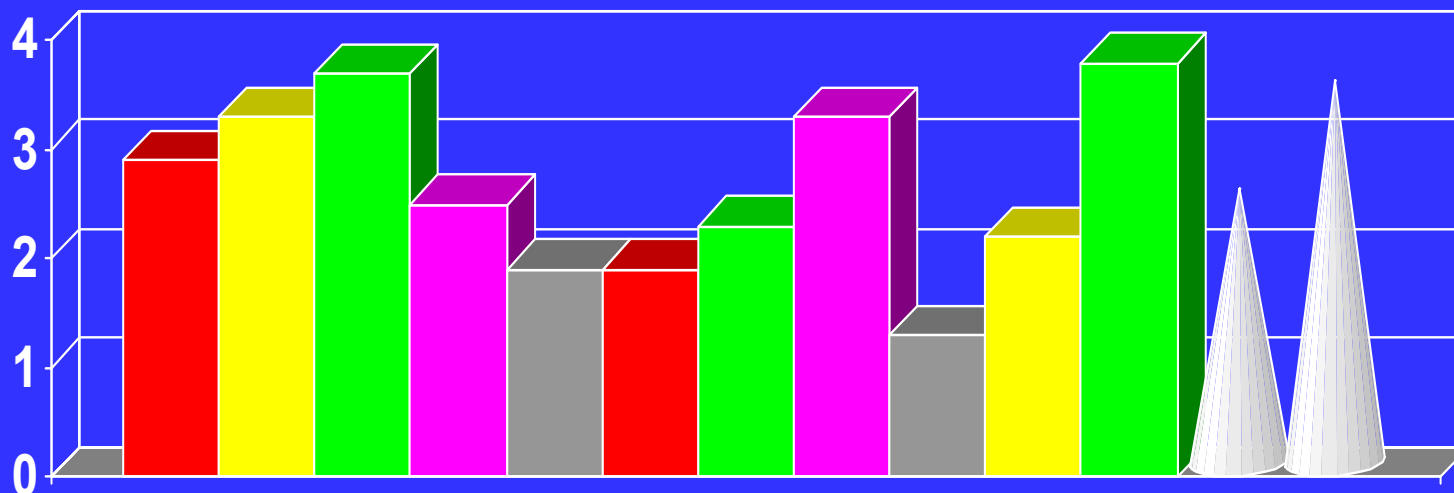
Annual Percent Change in CPI for Food Away from Home



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Slower Growth in Food-at-Home CPI

Annual Percent Change in CPI for Food at Home



1994	1995	1996	1997	1998	1999	2000
2001	2002	2003	2004	2005 Low	2005 High	

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Why?

- Upward Pull on Retail Food Prices:
 - Higher Energy and Transportation Costs
 - Rising Labor Costs
 - Uncertainty in Commodity Prices
- Stabilizing Forces:
 - Better Inventory Management/Cost Saving Technologies
 - Globalized Trade: Year-round availability
 - Increased Competition from nontraditional retail formats.
 - Food away from home continues upward trend in share of food bill.
 - Increased demand by consumers for convenience, quality, *and* low prices.

Percent Change in Food CPI 2002-2005 (a)

Items	Actual 2002	Actual 2003	Actual 2004	Forecast 2005
All Food	1.8	2.2	3.4	2.5 to 3.5
FAFH	2.5	2.1	3.0	2.5 to 3.5
Food at Home	1.3	2.2	3.8	2.5 to 3.5
Beef	0.1	9.0	11.6	1.0 to 2.0
Pork	-0.4	1.9	5.6	1.0 to 2.0
Other Meats	3.5	2.5	4.5	1.5 to 2.5
Poultry	1.3	1.3	7.5	2.0 to 3.0

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Percent Change in Food CPI 2002-2005 (b)

Items	Actual 2002	Actual 2003	Actual 2004	Forecast 2005
All Food	1.8	2.2	3.4	2.5 to 3.5
Food at Home	1.3	2.2	3.8	2.5 to 3.5
Fish and Seafood	-1.6	1.0	2.3	2.0 to 3.0
Dairy	0.6	-0.1	7.3	2.5 to 3.5
Fats and Oils	-0.2	1.3	6.6	3.0 to 4.0
Sugar + Sweets	2.1	1.9	0.7	0.0 to 1.0
Eggs	1.3	13.8	6.2	-4.0 to -3.0

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Percent Change in Food CPI 2002-2005 (c)

Items	Actual 2002	Actual 2003	Actual 2004	Forecast 2005
All Food	1.8	2.2	3.4	2.5 to 3.5
Food at Home	1.3	2.2	3.8	2.5 to 3.5
Fresh Fruits	1.9	3.3	2.8	3.0 to 4.0
Fresh Vegetables	6.4	2.1	4.3	3.5 to 4.5
Processed F + V	3.7	0.9	1.3	1.0 to 2.0
Cereals + Bakery	2.2	2.4	1.6	2.5 to 3.5
Nonalcoholic Bev.	0.0	0.4	0.4	0.0 to 1.0

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Food Price Inflation on the Decline

Average Annual Percent Change in Food Price Inflation by Decade

