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THE OUTLOOK FOR FOOD PRICES IN 2004

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Increased consolidation among food retailers has left a smaller number of companies with a greater share of the retail food market. As of 2003, the top 4 food retailers accounted for 25.5 percent of grocery sales up from 16.2 percent in 1995. Many industry analysts have feared that consolidation would create less competitive markets and higher food prices, with less pressure on retailers to develop and improve the quality of goods and services available to their customers. However, the opposite trend has taken hold. Conventional food retailers now 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. In fact, the share of at-home food sales for warehouse clubs and discount supercenters rose dramatically, from 1.8 percent in 1991 to 11.1 percent by 2003. On a second front, conventional food retailers also face greater competition from restaurants and other food away from home market options for consumers' food dollars.

Conventional supermarkets have been forced to compete with these alternative food outlets by lowering prices and by differentiating their product from those available at their competitors. Recent retail food prices reflect these market dynamics. The expanding services offered by retailers may increase their operating costs, but the competitive pressure from warehouse clubs, supercenters, dollar stores, and restaurants continue to keep prices for standard food items at relatively low inflation levels.

This trend of overall low food price inflation was evident in most food categories in 2003 with the all food Consumer Price Index (CPI) rising just 2.2 percent for the year. The CPI for all food is forecast to increase 2.2 to 3.2 percent in 2004, as the current trends in retail food markets will be partially offset by the overall improving economy to raise food price inflation slightly above 2003 levels, but still fairly steady over the next year.

Food Away From Home

The CPI for food away from home increased 2.1 percent in 2003 as consumers continued their shift to greater consumption of food away from home as convenience and transportability continue to be of high priority for time-pressed consumers. Price inflation for food away from home was slightly lower than that of food at home (2.1 vs. 2.2) which is a common trend in post-recession years. At 2.1 percent, food away from home price inflation was lower than that of 2002 (2.5) and continued a decreasing trend from 2001 (2.9). It was also the lowest food away from home inflation change since 1994. With the economy improving in 2004, consumers will be increasing their demand for food away from home and that should push prices above this

year's inflation levels. The food away from home CPI is forecast to increase 2.0 to 3.0 percent in 2004

Looking at the components of the CPI for food away from home, full service meals and snacks (restaurants), representing 53 percent of the index, increased 2.0 percent in 2003, while limited service meals and snacks (fast-food establishments), representing 29 percent of the index, also increased 2.0 percent in 2003.

Food at Home

Food-at-home prices increased 2.2 percent in 2003 just under the 10 year annual average of 2.6 percent. Forecasts for 2004 predict similar low inflation for food at home in the 2.5 to 3.5 percent range with the slight possible increase from the 2003 price increase due to an improving overall economy forecast for 2004, but mostly offset by expected price decreases for beef products in light of the discovery of Bovine Spongiform Encephalopathy (BSE) in one cow in the U.S. in December 2003 and the subsequent export ban on U.S. beef imposed by many countries. 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. Food-at-home prices rose an average of just 2.2 percent per year over the past 5 years (1999-2003) as opposed to 3.3 percent average annual growth in the prior 10 years (1989-1998).

In summarizing 2003 food-at-home price increases, the big changes in prices occurred in the beef and egg categories. Egg prices jumped 13.8 percent in 2003, while beef prices were up 9.0 percent for the year. Increased competition between food retailers and surplus supplies in certain commodity categories led to relatively low price increases everywhere else with the average increase of just 1.5 percent for all food-at-home categories excluding beef and eggs. The following discussion highlights 2003 prices and focuses on expected CPI changes for 2004:

Meats. U.S. red meat and poultry production is expected to rise 0.7 percent in 2004 after decreasing 0.3 percent in 2003. Along these lines, beef production fell 3.2 percent in 2003, while poultry and pork production were up 1.3 and 0.8 percent, respectively. With fewer exports projected in 2004 due to the BSE situation leading to slightly higher domestic supplies, retail prices will remain rather stable in 2004, currently forecast to decrease 0.0 to 1.0 percent in 2004.

Beef and Veal. The CPI for beef and veal rose 9.0 percent in 2003 (the largest annual increase since 1979), but is expected to decrease 3.0 to 4.0 percent in 2004. The large increase in beef prices in 2003 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 one case of BSE reported in Canada and the subsequent import ban on Canadian beef. With the discovery of one case of BSE in the U.S. in December 2003, these price increases have begun to reverse themselves and due to the current export ban by many countries on U.S. beef, retail prices should fall this year as suppliers adjust to greatly diminished export demand.

Pork. The CPI for pork to rose 1.9 percent in 2003. The CPI for pork is expected to increase 0 to 1 percent in 2004, as pork demand appears to remain steady or increase slightly in response to higher quality, greater consistency, and larger cut size offered by the industry while supplies will be slightly higher than 2003 levels.

Other meats increased 2.5 percent in 2003, and 2004 prices are expected to increase 0 to 1 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 remain rather steady in 2004.

Poultry. The CPI for poultry increased 1.3 percent in 2003, with an increase of 1 to 2 percent expected in 2004. Broiler production in 2004 is forecast at 33.3 billion pounds, up slightly from 32.3 billion pounds in 2003. Turkey production totaled 5.6 billion pounds in 2003, with 2004 production forecast to remain flat.

Fish and seafood. The CPI for fish and seafood was up 1.0 percent in 2003, with an expected 2 to 3 percent increase in 2004, mostly coming towards the end of the year as country of origin labeling rules are put into effect. The small increase in fish and seafood prices was mostly due to increased demand for protein products in 2003 and this trend should continue into 2004, as well. In the 1990's, U.S. per capita seafood consumption remained flat, between 14.8 and 15.2 pounds of edible meat per year, with any increases in total domestic seafood consumption coming from population growth.

Eggs. Retail egg prices jumped 13.8 percent in 2003, the first double digit increase since 1996. A combination of a slightly smaller laying flock, flat production and a strengthening economy have pushed egg prices up to their highest levels in the history of the CPI. As production increases in response to the current high prices, prices will begin to stabilize and are forecast to increase 1.5 to 2.5 percent on 2004.

Dairy and related products prices decreased 0.1 percent in 2003, but are expected to increase 2.0 to 3.0 percent in 2004, mostly due to continued expected increases in milk prices. Increased competition among retailers has kept dairy prices relatively low when compared to other food products, but this trend that may reverse itself, especially in terms of milk prices.

Fats and oils increased 1.3 percent in 2003 and are expected to increase 2.0 to 3.0 percent in 2004. The increase in the 2003 index was largely offset by a 7.6 percent decrease in the retail price of butter. Butter accounts for 31 percent of the fats and oils index. 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.

Fresh fruits. The CPI for fresh fruits increased 3.3 percent in 2003 and is expected to increase 3 to 4 percent in 2004, as retailers use the quality of produce as a selling point to attract customers and increase their market share.

Fresh vegetables. The CPI for fresh vegetables increased just 2.1 percent in 2003, the lowest increase since 1999. Prices are expected to rise an additional 4.0 to 5.0 percent in 2004 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 2004.

Processed fruits and vegetables. The CPI for processed fruits and vegetables increased 0.9 percent in 2003 and is expected to increase 0.0 to 0.5 percent in 2004. Since frozen and other processed fruit and vegetable demand has been shown to be income sensitive, 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 2003 CPI index increase for sugar and sweets to only 1.9 percent. In 2004, 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 1.7 percent in 2003; candy and chewing gum which are 60.6 percent of the index and increased 1.5 percent in 2003; and other sweets (jellies, jams, preserves, and syrups) which are 20.7 percent of the index and increased 3.5 percent in 2003.

Cereal and bakery products. With inflation-related processing relatively low and highly competitive markets for most packaged products, the CPI for cereals and bakery products increased just 2.4 percent in 2003. The CPI for cereal and bakery products is expected to increase 2.5 to 3.5 percent in 2004 as the improving economy will push demand for new cereal and bakery products slightly higher than the 2003 price change levels. This index has two sub-categories. They include cereals and cereal products which are 35 percent of the index and increased 1.9 percent in 2003; and bakery products which are 65 percent of the index and increased 2.7 percent. 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 2003 and is forecast to increase 0.0 to 1.0 percent in 2004. 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 2003 for coffee (up 1.6 percent) and nonfrozen noncarbonated juices and drinks (up 0.1 percent), while carbonated drink prices remained unchanged in 2003.

Other foods. The CPI for other foods increased 1.0 percent in 2003 and is forecast to increase 2.0 to 3.0 percent in 2004. 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, the first decade of the 21st century will likely continue the historical decline in average annual food price inflation. 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 2.6 percent. Current USDA Baseline Projections predict average annual food price inflation of just 2.2 percent for the current decade.

**Changes in Food Price Indicators
2002 through 2004**

Items	Relative importance ^{1/}	2002	Final 2003	Forecast 2004
	--Percent--	-----Percent Change-----		
All Food	100.0	1.8	2.2	2.2 to 3.2
Food Away From Home	42.3	2.5	2.1	2.0 to 3.0
Food at Home	57.7	1.3	2.2	2.5 to 3.5
Meats	9.9	0.6	5.4	-1.0 to 0.0
Beef and Veal	4.7	0.1	9.0	-4.0 to -3.0
Pork	3.2	-0.4	1.9	0.0 to 1.0
Other Meats	2.0	3.5	2.5	0.0 to 1.0
Poultry	2.8	1.3	1.3	1.0 to 2.0
Fish and Seafood	2.1	-1.6	1.0	2.0 to 3.0
Eggs	0.6	1.3	13.8	1.5 to 2.5
Dairy and related products	6.2	0.6	-0.1	2.0 to 3.0
Fats and Oils	1.8	-0.2	1.3	2.0 to 3.0
Fruits and Vegetables	8.2	4.1	2.3	3.0 to 4.0
Fresh Fruits and Vegetables	6.3	4.2	2.7	3.5 to 4.5
Fresh Fruits	3.2	1.9	3.3	3.0 to 4.0
Fresh Vegetables	3.1	6.4	2.1	4.0 to 5.0
Processed Fruits & Vegetables	1.9	3.7	0.9	-0.5 to 0.5
Sugar and Sweets	2.1	2.1	1.9	0.0 to 1.0
Cereals and Bakery Products	8.8	2.2	2.4	2.5 to 3.5
Nonalcoholic Beverages	6.6	0.0	0.4	0.0 to 1.0
Other Foods	8.4	0.6	1.0	2.0 to 3.0

^{1/} BLS estimated expenditure shares, December 2001.

Retail Food Price Outlook

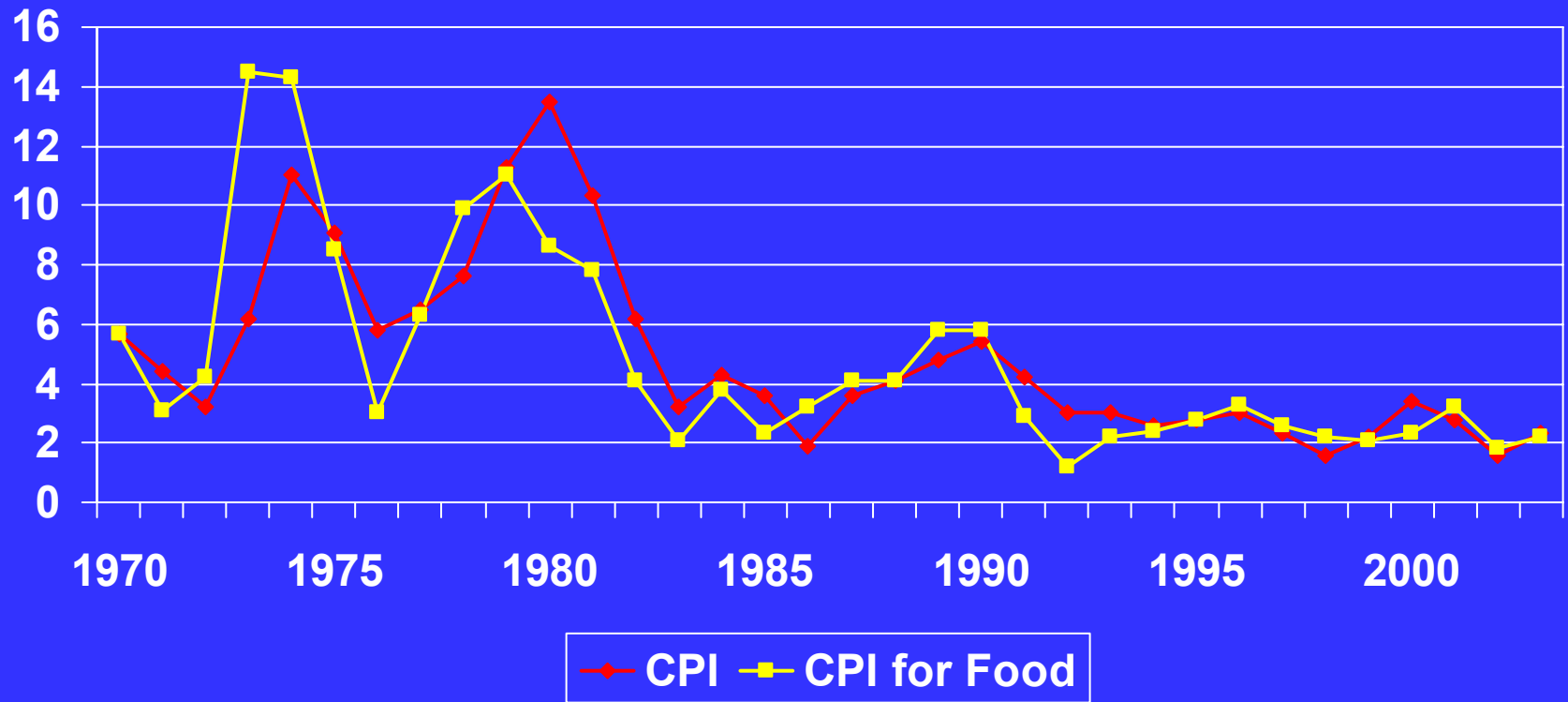
Ephraim Leibtag

ERS-USDA

February 19, 2004

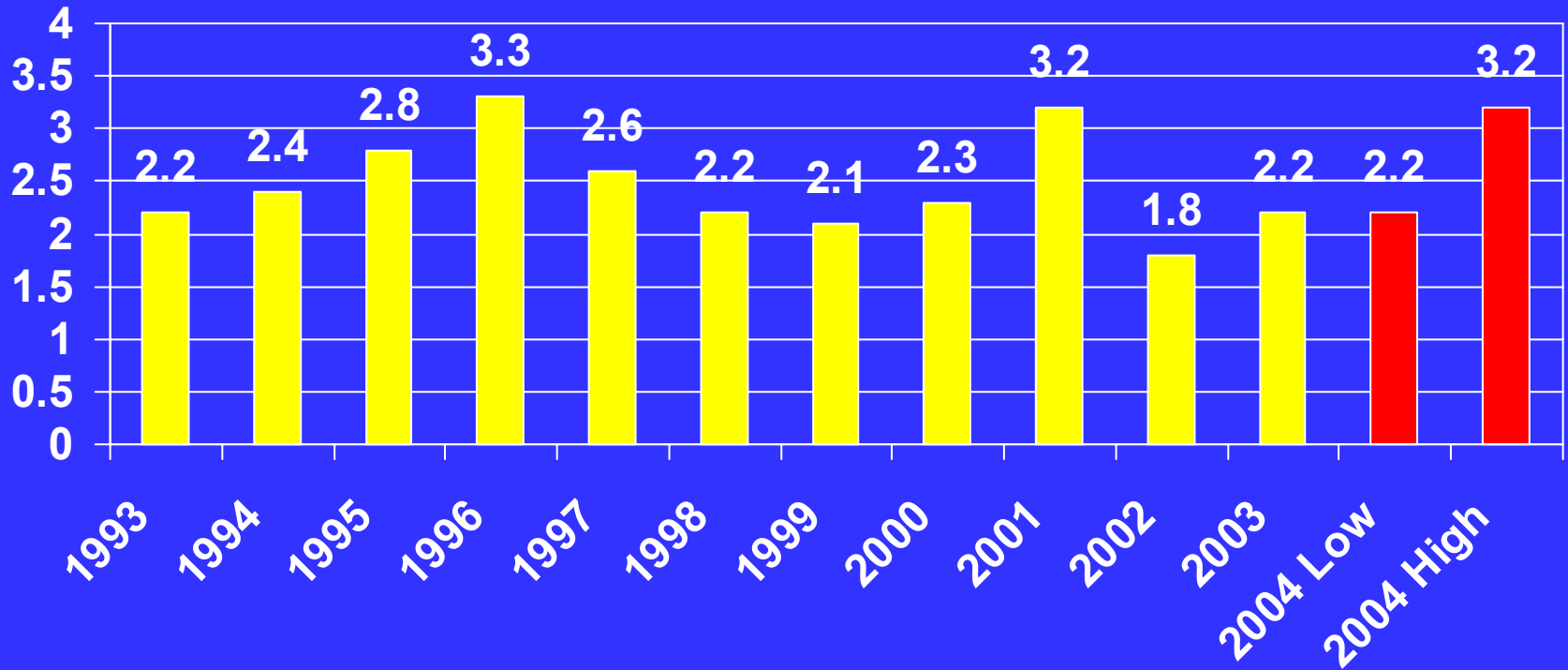
CPI vs CPI for Food 1970-2003

Annual Percent Change in CPI and CPI for Food



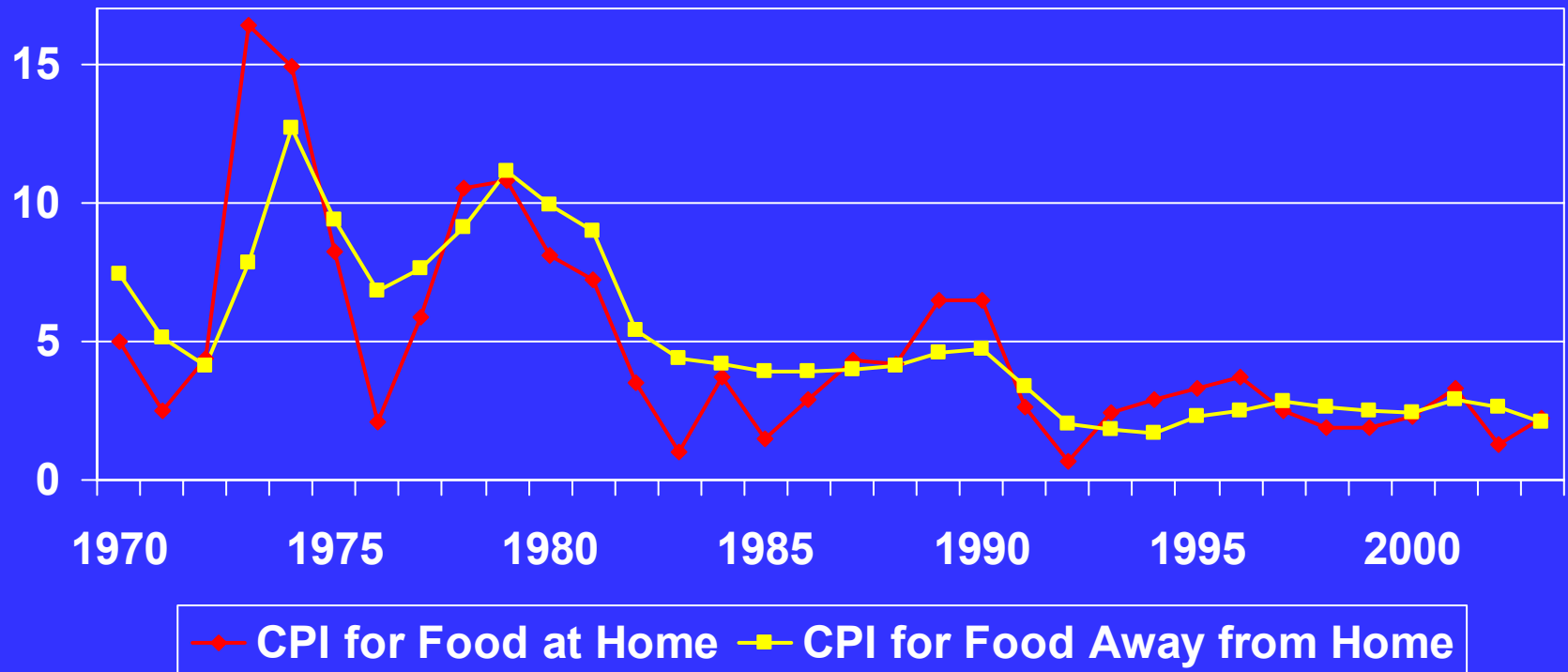
Moderate Growth in CPI for Food Expected to Continue

Annual Percent Change in CPI for Food



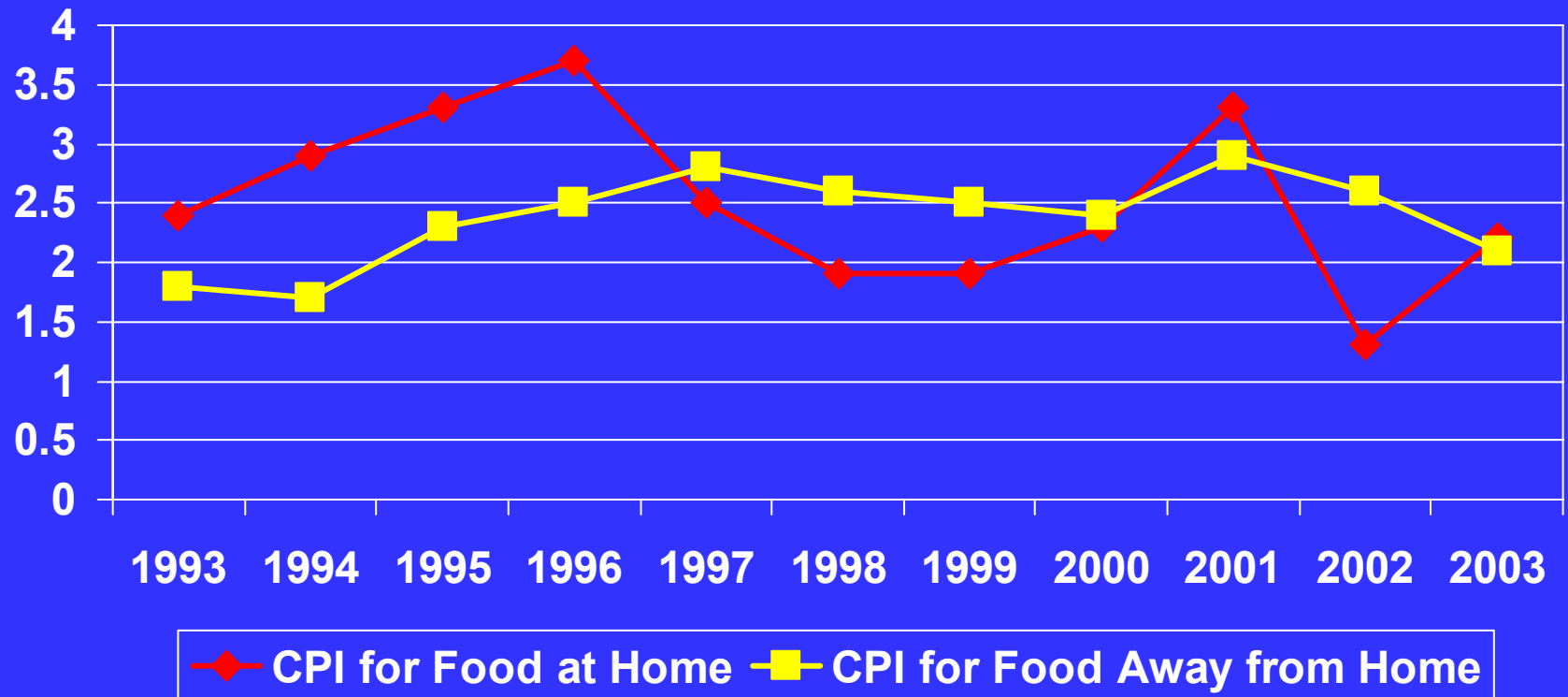
Food at Home vs Food Away from Home 1970-2003

Annual Percent Change



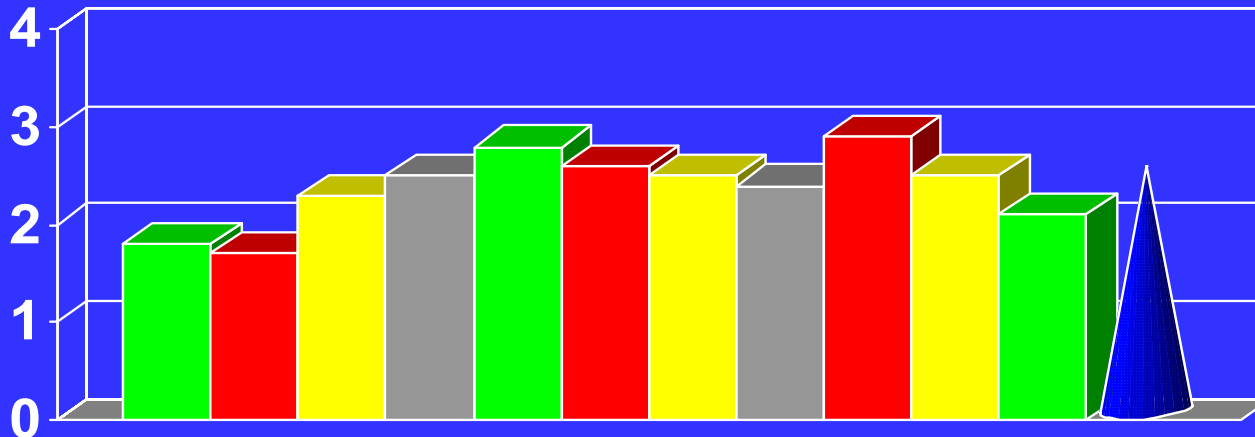
Food at Home vs Food Away from Home 1993-2003

Annual Percent Change



Food Away from Home CPI Shows Steady Growth

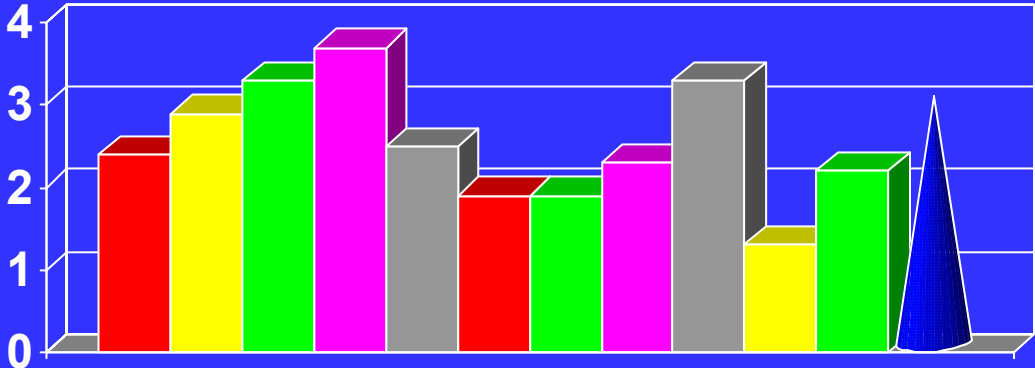
Annual Percent Change in CPI for Food Away from Home



1993	1994	1995	1996	1997	1998
1999	2000	2001	2002	2003	*2004*

Food-at-Home CPI on the Rise

Annual Percent Change in CPI for Food at Home



1993	1994	1995	1996	1997	1998
1999	2000	2001	2002	2003	*2004*

Why?

- Improving Economy
- Increased Producer/Commodity Prices
- Increased Competition
 - Increased market share for alternative retail outlet formats
 - Food away from home continues upward trend in share of food bill.
- Increased demand by consumers for convenience, quality, *and* low prices.
- Better Inventory Management/Cost Saving Technologies
- Globalized Trade: Year-round availability

Percent Change in Food CPI 2001-2003 (a)

Items	Actual 2002	Actual 2003	Forecast 2004
All Food	1.8	2.2	2.2 to 3.2
FAFH	2.5	2.1	2.0 to 3.0
Food at Home	1.3	2.2	2.5 to 3.5
Beef	0.1	9.0	-4.0 to -3.0
Pork	-0.4	1.9	0.0 to 1.0
Other Meats	3.5	2.5	0.0 to 1.0
Poultry	1.3	1.3	1.0 to 2.0

Percent Change in Food CPI 2001-2003 (b)

Items	Actual 2002	Actual 2003	Forecast 2004
All Food	1.8	2.2	2.2 to 3.2
Food at Home	1.3	2.2	2.5 to 3.5
Fish and Seafood	-1.6	1.0	2.0 to 3.0
Dairy	0.6	-0.1	2.0 to 3.0
Fats and Oils	-0.2	1.3	2.0 to 3.0
Sugar + Sweets	2.1	1.9	0.0 to 1.0
Eggs	1.3	13.8	1.5 to 2.5

Percent Change in Food CPI 2001-2003 (c)

Items	Actual 2002	Actual 2003	Forecast 2004
All Food	1.8	2.2	2.2 to 3.2
Food at Home	1.3	2.2	2.5 to 3.5
Fresh Fruits	1.9	3.3	3.0 to 4.0
Fresh Vegetables	6.4	2.1	4.0 to 5.0
Processed F + V	3.7	0.9	-0.5 to 0.5
Cereals + Bakery	2.2	2.4	2.5 to 3.5
Nonalcoholic Bev.	0.0	0.4	0.0 to 1.0

Food Price Inflation on the Decline

Average Annual Percent Change in Food Price Inflation by Decade

