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THE OUTLOOK FOR FOOD PRICES IN 2003

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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 2000, the top 4 food retailers accounted for 27.4 percent of grocery sales, up from 16.2 percent in 1995. Many industry analysts feared 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 Wal-Mart Supercenters, Costco Warehouse Stores, and other alternative retail formats who are increasingly offering a larger array of food products to their price sensitive customers. In fact, the share of at-home food sales for warehouse clubs and supercenters rose dramatically, from 1.8 percent in 1991 to 7.4 percent in 2001. 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, and restaurants continue to keep prices for standard food items at low inflation levels.

This trend of overall low food price inflation was evident throughout 2002 with the all food Consumer Price Index (CPI) rising just 1.8 percent for the year. This is the smallest increase in food prices since 1992. The CPI for all food is forecast to increase 1.5 to 2.5 percent in 2003, as the current trends in retail food markets along with the overall slumping economy will work to keep food prices fairly steady over the next year.

The two main components of the all food CPI, food at home and food away from home saw clear differences in their magnitudes in 2002.

Food Away From Home

The CPI for food away from home increased 2.6 percent in 2002 as consumers continued their shift to greater consumption of food away from home despite relatively higher prices and a weaker economy. Price inflation for food away from home was double that of food at home, yet at 2.6 percent was slightly lower than that of 2001. In 2003 the food away from home CPI is forecast to increase 2.0 to 2.5 percent. The slightly lower price increase projected for food away from home is due to the continuing weak economy and greater competition both within the

classic food away from home market as well as new competition in terms of more prepared foods offered by supermarkets and grocery stores.

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 2.4 percent in 2002, while limited service meals and snacks (fast-food establishments), representing 29 percent of the index, increased 2.8 percent in 2002.

Food at Home

Food-at-home prices remained steady throughout 2002, rising only 1.3 percent for the year. This is the smallest increase in food at home prices since 1992 and is just over half the 10 year annual average of 2.5 percent. Forecasts for 2003 predict similar low inflation for food at home in the 1.5 to 2.0 percent range with the slight increase from the 2002 price increase due to an improving overall economy forecast for the end of 2003. 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 food prices even lower than one would normally expect during slow economic growth periods. This is evident by looking over a longer time horizon- food-at-home prices rose an average of just 2.1 percent per year over the past 5 years (including the boom years of the late 1990s) as opposed to 3.5 percent average annual growth in the prior 10 years (1998-1997).

In summarizing 2002 food-at-home price increases, a weak economy, increased competition between food retailers, and surplus supplies in certain commodity categories led to relatively low price increases for meat, poultry, dairy products, eggs, and fresh fruits and deflation in the prices of pork, fish and seafood, and fast and oils. Only fresh vegetables, processed fruits and vegetables, sugars and sweets, and cereals and bakery products saw prices rise more than 2 percent. The following discussions highlight 2002 prices and focus on expected CPI changes for 2003:

Meats. U.S. red meat and poultry production is expected to fall 1 to 2 percent in 2003 after posting a 3.3 percent gain in 2002. Along these lines, beef production rose 3.8 percent in 2002, reflecting several years of cattle herd reductions and continued high heifer slaughter. Despite the expected decrease in meat production, a relatively weak U.S. economy and increased competition in retail markets will keep retail prices rather stable, currently forecast to rise 2 to 2.5 percent in 2003.

Beef and Veal. The CPI for beef rose just 0.1 percent in 2002 and is expected to increase 1.5 to 2 percent in 2003. The weak economy dampened the demand for higher quality cuts of beef, which should continue into early 2003 with a slight increase in price forecasted for the second half of 2003.

Pork. Increased pork production caused the CPI for pork to fall 0.4 percent in 2002. The CPI for pork is expected to increase 0 to 1 percent in 2003, 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 lower than 2002 levels.

Other meats increased 3.5 percent in 2002, but 2003 prices are expected to drop 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.

Poultry. The CPI for poultry increased 1.3 percent in 2002, with an increase of 1 to 2 percent expected in 2003. Broiler production in 2003 is forecast at 32.5 billion pounds, up slightly from 32.3 billion pounds in 2002. Turkey production totaled 5.7 billion pounds in 2002, with 2003 production forecast to remain flat.

Fish and seafood. The CPI for fish and seafood was down 1.6 percent in 2002, with an expected 1 to 2 percent increase in 2003. The decrease in price in 2002 was mostly due to consumer's shifting demand away from fish and seafood purchased for at home consumption to increased poultry and meat consumption as well as fish and seafood consumed away from home. 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 increased 1.3 percent in 2002, with a 0 to -1 percent decrease expected in 2003.

Dairy and related products prices increased 0.6 percent in 2002 and are expected to increase 1.5 to 2 percent in 2003. Strong consumer demand for dairy items, especially gourmet ice cream, cheese, and butterfat products kept price change on the positive side for 2002. However increased competition among retailers continues to keep dairy prices relatively low when compared to other food products and inflation, in general. This is most likely due to retailers using dairy products as loss leaders to increase traffic in their stores.

Fats and oils decreased 0.2 percent in 2002 and are expected to increase just 0 to 1 percent in 2003. The decrease in the 2002 index was largely due to lower retail prices for butter, which decreased 9.1 percent in 2002. 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 1.9 percent in 2002 and is expected to increase 3 to 4 percent in 2003, 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 6.4 percent in 2002 and is expected to rise an additional 4 to 5 percent in 2003 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 2003.

Processed fruits and vegetables. With lower supplies of both fruits and vegetables, the CPI for processed fruits and vegetables increased 3.7 percent in 2002 and is expected to increase 2.5 to 3.5 percent in 2003. Since frozen fruit and vegetable demand has been shown to be income sensitive, in the current economic climate retailers will be hard-pressed to raise prices more than a modest amount in the coming year.

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 2002 CPI index increase for sugar and sweets to only 2.1 percent. With a relatively weak economy expected for at least the first half of 2003, the CPI for sugar and sweets is expected to increase a moderate 1 to 2 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 2.1 percent in 2002; candy and chewing gum which are 60.6 percent of the index and increased 1.8 percent in 2002; and other sweets (jellies, jams, preserves, and syrups) which are 20.7 percent of the index and increased 3.0 percent in 2002.

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 2.2 percent in 2002 and is expected to increase 1 to 2 percent in 2003. This index has two sub-categories. They include cereals and cereal products which are 35 percent of the index and increased 1.7 percent in 2002; and bakery products which are 65 percent of the index and increased 2.4 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 was unchanged in 2002 and is forecast to increase 0.5 to 1.5 percent in 2003. 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 slightly higher in 2002 for carbonated drinks (up 0.2 percent) and nonfrozen noncarbonated juices and drinks (up 0.4 percent), but significantly lower for coffee (down 2.8 percent) continuing the downward trend that began in coffee prices in 1996 as coffee has become more of a food away from home product.

Other foods. The CPI for other foods increased just 0.6 percent in 2002 and is forecast to increase 1.5 to 2.5 percent in 2003. 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 2001 through 2003

Items	Relative importance ^{1/}	2001	Final 2002	Forecast 2003
	--Percent--		-----Percent Change-----	
All Food	100.0	3.2	1.8	1.5 to 2.5
Food Away From Home	42.3	2.9	2.6	2.0 to 2.5
Food at Home	57.7	3.3	1.3	1.5 to 2.0
Meats	9.9	5.7	0.6	2.0 to 2.5
Beef and Veal	4.7	8.4	0.1	1.5 to 2.0
Pork	3.2	3.8	-0.4	0.0 to 1.0
Other Meats	2.0	2.9	3.5	-1.0 to 0.0
Poultry	2.8	3.2	1.3	1.0 to 2.0
Fish and Seafood	2.1	0.5	-1.6	1.0 to 2.0
Eggs	0.6	3.5	1.3	-1.0 to 0.0
Dairy and related products	6.2	4.0	0.6	1.5 to 2.0
Fats and Oils	1.8	5.6	-0.2	0.0 to 1.0
Fruits and Vegetables	8.2	3.7	4.1	3.5 to 4.5
Fresh Fruits and Vegetables	6.3	3.8	4.2	3.5 to 4.5
Fresh Fruits	3.2	2.6	1.9	3.0 to 4.0
Fresh Vegetables	3.1	5.1	6.4	4.0 to 5.0
Processed Fruits & Vegetables	1.9	3.2	3.7	2.5 to 3.5
Sugar and Sweets	2.1	1.2	2.1	1.0 to 2.0
Cereals and Bakery Products	8.8	3.0	2.2	1.5 to 2.5
Nonalcoholic Beverages	6.6	1.0	0.0	0.5 to 1.5
Other Foods	8.4	2.2	0.6	1.5 to 2.5

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