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***THE OUTLOOK FOR FOOD PRICES IN 1998***

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After increasing 2.6 percent in 1997, the Consumer Price Index (CPI) for food is expected to increase 2 to 3 percent in 1998. If the increase is around 2 percent, it may be the smallest price increase since the early 1990's, when food prices increased 1.2 percent in 1992 and 2.2 percent in 1993.

Although 1998 looks like a good year for lower food prices, there are a couple of factors that may determine if the increase is closer to 2 or 3 percent. The first unknown is whether the sluggish export market for beef, pork, and poultry continues throughout 1998 and the second uncertainty is if the current strong El Nino and unsettled weather patterns continue through spring 1998 in the fresh vegetable growing areas of Florida, California, Arizona, Texas, and Mexico. These two factors could have a major effect on the food at home index in 1998 since the CPI's for beef, pork and poultry account for 20 percent of the food at home CPI, while fruits and vegetables account for an additional 20 percent. Another factor that may skew the individual food category indexes is the re-weighting of all CPI items by the Bureau of Labor Statistics (BLS) this year. After the re-weighting, we are anticipating that the weight for food away from home (currently 36.9 percent) will increase in importance by an additional 1 or 2 percent over food at home (currently 63.1 percent), as a percent of all food.

Retail food price changes are underpinned by general economic factors that influence food prices and the relationship between farm and marketing costs. In recent years, food price increases have been small due to the low general inflation rate, which is forecast to increase 2 to 3 percent in 1998; a larger share of the food dollar going to purchases of food away from home, which has been over 47 percent the past two years; the continued decline in the farm value share of the retail price for most food items, which is expected to average 24 or 25 cents in 1997 and 1998; and increasing economies of size in the farm sector.

Food price changes are also a key variable determining what proportion of income consumers spend for food and what is left for purchases of other goods and services. In 1996, 10.9 percent of household disposable personal income went to pay for food, with 6.7 percent for food at home and 4.2 percent for food away from home. The downward trend in the proportion of household disposable personal income going toward food should continue into 1997 and 1998. Preliminary figures on food sales for 1997, show food at home spending up 2.5 percent and away from home spending up 3.7 percent. After adjusting 1997 food sales for inflation, which provides an indicator of food quantities actually purchased, food at home spending went down 0.1 percent while food away from home spending went up 0.8 percent. With continued competition between grocery stores, restaurants and fast-food establishments, this pattern is expected through 1998.

The food at home CPI increase of 2.5 percent in 1997 was moderated by lower grain prices, large supplies of competing meats, adequate supplies of fresh fruits and vegetables, increased sugar production, and strong competition in the soft drink and prepared food industries. The 1997 CPI increase of 2.8 percent for food away from home, was the largest increase since 1991 and was partly driven by tighter labor markets that have increased general wages. However, competition among restaurants and fast-food establishments remained strong and held down the full pass-through of higher wage and raw materials costs to consumers. An additional pass-through is expected through early 1998.

A discussion of some individual categories of the CPI for food can help explain price changes in 1997 and expected changes in 1998. In summarizing 1997 food price increases, lower grain prices encouraged increases in pork, poultry, milk, and egg production; cereal and bakery product price increases were also smaller because of lower grain prices; plentiful supplies of fruits and vegetables led to smaller retail price increases; and while coffee prices were up for 6 months in 1997, lower prices for carbonated beverages during the same period mitigated the increase for the nonalcoholic beverages index.

- **Meats.** U.S. livestock and poultry prices are under pressure from large meat supplies and reduced prospects for exports in 1998. In addition to large U.S. meat supplies, the currency devaluations in other countries and the need to find alternative meat markets due to economic problems in Asia are making the U.S. a more attractive market for foreign exporters and hurting the U.S. in world competition. As a result, net exports of U.S. red meat are expected to shrink in 1998, further adding to abundant meat supplies competing for the U.S. consumer dollar. As a result, the meat, poultry and fish index, which increased 2.9 percent in 1997 is expected to drop up to 2 percent in 1998.
- **Beef and veal.** Commercial beef production in 1998 is expected to fall 1 to 2 percent, from 1997 levels. The Asian financial crisis and the strong U.S. dollar are expected to lead to lower beef exports and rising imports, as the U.S. becomes a lucrative market due to the strength of the dollar. U.S. beef exports are likely to decline almost 7 percent in 1998, as declining sales to the Pacific Rim overwhelm any increased sales to Mexico. After increasing a modest 1.7 percent in 1997, the CPI for beef and veal is expected to increase at about the same rate in 1998, from 0 to 2 percent, as large supplies of competing meats and a less than robust international trade scenario hold down price increases in 1998, until at least late summer.
- **Pork.** With expectations of plentiful supplies of pork and competing meats throughout 1998, pork retail prices are expected to fall 4 to 6 percent, after increasing 5.2 percent in 1997. Forecast of a 9 percent increase in pork production in 1998 should lead to the largest per capita consumption rate since 1994, increasing 5 pounds from 1997 levels to almost 70 pounds per person. U.S. pork exports in 1998 are expected to be 990 million pounds, off 10 percent from previous estimates because of expected reductions in Asian demand. In particular, U.S. exports to Japan are expected to be down in 1998, due to losses in market share to lower priced Korean pork products and a stronger U.S. dollar.
- **Other meats** increased 2.8 percent in 1997, and in 1998 prices are expected to remain

flat, from -1 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.** Broiler meat production for 1998 is expected to be almost 29 billion pounds, up 5 to 6 percent from 1997. However, 1998 turkey production is expected to be unchanged from 1997, as weak net returns in 1996 and 1997 put pressure on turkey producers to hold down production levels. During the past several months, export prospects for U.S. poultry have become less certain due to the continuing financial crisis in many Asian countries; depreciated currencies in Thailand and Brazil, which give them a price advantage over the U.S. in many major markets; and the outbreak of Avian influenza in Hong Kong, which was the second largest market for U.S. broilers and turkeys. As these factors continue into 1998, production increases will likely slow down, with the CPI for poultry expected to be between -1 and 1 percent, after increasing 2.8 percent in 1997.
- **Fish and seafood.** The CPI for fish and seafood was up 2.3 percent in 1997, with an expected 1 to 3 percent increase in 1998. Almost 50 percent of the fish and seafood consumed in the U.S. comes from imports, with the remaining amount from U.S. farm raised production. Imports for 1997 were up--salmon, shrimp, crawfish, mussels, tilapia, and oysters. Domestic production of catfish and trout was also up, with the U.S. having one of the world's largest fishing industries with year-round production. In the 1990's, U.S. per capita seafood consumption has 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.** After volatile egg prices in 1996 and a CPI increase of 18.0 percent, higher production and lower export levels during 1997 led to larger U.S. consumption of eggs and lower average retail prices. With table egg production expected to be about 2 percent higher in 1998, consumption is expected to increase again, to the highest level since 1988. Because of the higher production level in 1997, the CPI for eggs fell 1.5 percent, but is not expected to increase this year, averaging between -1 and 1 percent in 1998.
- **Dairy products.** Milk production in 1997 increased about 1 percent from 1996 levels, because of increased demand and lower feed costs. Increased production led to large U.S. commercial dairy stocks, particularly of nonfat dry milk and American cheese. These factors, along with a modest dairy product demand, led to a 2.4 percent CPI increase in 1997. With milk output expected to increase slightly this year, retail prices for dairy products are forecast to increase from 0 to 2 percent in 1998.
- **Fats and oils** increased 0.9 percent in 1997 and are expected to increase a modest 1 to 3 percent in 1998. Since fats and oils are highly processed food items, their price change is influenced by the general inflation rate in addition to U.S. and world supplies of vegetable oils. Soybean oil is the primary oil used in the production of vegetable oil products, however the relationship between soybeans and the retail price of vegetable oils is complex. Soybean oil is a joint product with soybean meal, which is primarily used for animal feed.

- **Fresh fruits.** Total fruit-bearing acreage has increased steadily for the past 5 years. Citrus fruit acreage has expanded because of re-plantings in Florida, after a freeze in the late eighties, that have begun to bear fruit. These trees, which include oranges and grapefruit, will be producing increasingly larger crops into the early 2000's. California has also expanded its orange production areas with most of their crop going for fresh use, while the majority of Florida's oranges are used for juice.

Summer fruits were also in abundant supplies 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., produced another large crop in 1997. Supplies of nectarines, plums, apricots, and sweet cherries were also abundant in 1997. Apple production was down about 2 percent in 1997, due to a smaller Washington crop and smaller fruit size in North Carolina and Virginia. Banana supplies, which are all imported, were sufficient to meet demand the past two years with retail prices averaging 49 cents per pound in both 1996 and 1997. The fresh fruit index increased a modest 0.8 percent in 1997, and is expected to increase 2 to 4 percent in 1998 due to continued U.S. consumer demand and projected larger exports.

- **Fresh vegetables.** The weather and growing conditions in the major fresh vegetable growing areas were mixed in 1997. A January freeze in Florida did minimum damage to several fresh market vegetables--squash, snap beans, green peppers, eggplant and tomatoes, with the impact on retail prices for these items less than originally expected. Fresh-market vegetables grown in other states and not affected by the freeze were--potatoes, lettuce, onions, celery, broccoli, cauliflower, and cabbage.

Growing conditions normalized during the spring and summer months, but then weather conditions changed again the last quarter of 1997. Torrential rains in Florida, rain and cold in the desert areas of California, Arizona, Texas, and an unusual December freeze in West Mexico led to lower supplies and higher retail prices for tomatoes, bell peppers, lettuce, and broccoli. In addition to the weather-related growing problems, retail prices for some fresh market vegetables and potatoes were higher in Fall 1997 because U.S. growers reduced harvested area from a year ago. On an annual basis, fresh vegetable prices increased 2.9 percent in 1997 and are expected to increase 3 to 5 percent in 1998. The size of the 1998 price increase depends on the continuation of unsettled weather patterns due to a strong El Nino through Spring 1998, changes in planting intentions, and expected higher prices for potatoes (the most heavily weighted item in the vegetable CPI).

- **Processed fruits and vegetables.** Contract acreage for the five leading processing vegetables (tomatoes, sweet corn, snap beans, green peas, and cucumbers) was down 3 percent in 1997, after a 9 percent decline in planted acreage a year earlier. However, processed vegetable prices increased a modest 2.3 percent in 1997 and are expected to increase 1 to 3 percent in 1998. The ready availability of fruit supplies also kept the CPI increase for processed fruits to 2.5 percent in 1997, with an expected increase of 0 to 2 percent in 1998.

- **Sugar and sweets.** Domestic sugar production was up to 7.2 million tons in 1996/97 and is projected up another 9 percent in 1997/98. Higher sugarbeet prices and lower prices for competing crops led to acreage increases in both years. Along with higher sugar output, lower retail prices for selected sugar-related food items in 1997 increased the sugar and sweets CPI by 2.9 percent. Although U.S. sugar consumption has grown at a rate of about 1.9 percent per year since 1985/86 and sugar use by industrial users has risen, the CPI is projected to increase a moderate 1 to 3 percent in 1998.
- **Cereal and bakery products** account for a large portion of the at home food CPI - almost 15 percent. While higher grain prices contributed to higher retail prices for selected bakery products in 1996, lower grain prices in 1997 held the increase to 2.1 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 a minor cost consideration. Competition for market share among the three leading breakfast cereal manufacturers led to the cereal component of this index falling 9.7 percent from 1995 to 1996, with an additional decrease of 1.4 percent from 1996 to 1997. With demand for cereal and bakery products as well as competition among producers expected to continue, the CPI for cereals and bakery products is expected to rise at a rate of 1 to 3 percent in 1998.
- **Nonalcoholic beverages.** Coffee and carbonated beverages are the two major components, accounting for 32 and 50 percent of the nonalcoholic beverages index. After falling 2.4 percent in 1996, due to lower coffee prices, the index increased 3.7 percent in 1997, due to higher coffee prices. Although coffee prices were up 12.6 percent in 1997, the increase in the nonalcoholic beverages index was mitigated by a drop of 1.4 percent in carbonated beverages. Competition in the soft drink industry by the two major competitors peaked during the summer months and continued through the end of 1997, leading to the reduction in the carbonated beverages index.

Speculation about a smaller 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 on the world market in spring and summer 1997. These price increases combined with low U.S. coffee stocks produced wholesale price fluctuations that led to higher retail prices for 6 months of the year. Fortunately, prices of Robusta coffee beans, the primary ingredient in retail store coffee blends did not increase as sharply as Arabica prices. Since the CPI for coffee reflects only coffee purchased in retail stores, smaller increases in Robusta prices along with the drop in the carbonated beverages index held down what might have been a larger increase in the nonalcoholic beverages price index in 1997. With coffee prices continuing to decline, the CPI for nonalcoholic beverages is expected to increase 1 to 3 percent.

- **Other prepared foods.** Other miscellaneous prepared foods are highly processed and are largely affected 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 market should continue to dampen retail price increases for

items in this category. In 1997, the CPI for this category increased 3.2 percent and is expected to increase 2 to 4 percent in 1998.

**Changes in Food Price Indicators  
1996 through 1998**

<b>Items</b>	<b>Relative importance <sup>1/</sup></b>	<b>1996</b>	<b>Final 1997</b>	<b>Forecast 1998</b>
	<b>--Percent--</b>		<b>-----Percent Change-----</b>	
All Food	100.0	3.3	2.6	2 to 3
Food Away From Home	37.3	2.5	2.8	2 to 3
Food at Home	62.7	3.7	2.5	1 to 3
Meats	12.2	3.5	3.0	-2 to 0
Beef and Veal	6.2	-0.3	1.7	0 to 2
Pork	3.4	9.8	5.2	-6 to -4
Other Meats	2.5	3.6	2.8	-1 to 1
Poultry	2.7	6.2	2.8	-1 to 1
Fish and Seafood	2.4	0.9	2.3	1 to 3
Eggs	1.0	18.0	-1.5	-1 to 1
Dairy Products	7.4	7.0	2.4	0 to 2
Fats and Oils	1.6	2.4	0.9	1 to 3
Fruits and Vegetables	12.7	3.5	2.0	2 to 4
Fresh Fruits and Vegetables	8.9	2.8	1.7	3 to 5
Fresh Fruits	4.5	7.1	0.8	2 to 4
Fresh Vegetables	4.5	-2.0	2.9	3 to 5
Processed Fruits and Vegetables	3.8	5.0	2.4	1 to 3
Processed Fruits	2.1	5.8	2.5	0 to 2
Processed Vegetables	1.6	4.0	2.3	1 to 3
Sugar and Sweets	2.1	4.5	2.9	1 to 3
Cereals and Bakery Products	9.2	3.9	2.1	1 to 3
Nonalcoholic Beverages	5.0	-2.4	3.7	1 to 3
Other Prepared Foods	6.5	3.4	3.2	2 to 4

<sup>1/</sup> BLS estimated expenditure shares.