FOOD MARKETING INSTITUTE

FOOD PRICES

Food inflation in 2006 was 2.1 percent, less than the overall inflation rate of 2.5 percent, according to the Bureau of Labor Statistics — continuing a more than two-decade trend of low to moderate rates (Figure 1). In fact, the inflation rate for food from retail stores, food-at-home, was only 1.4 percent in 2006.

Food prices are projected to rise 2.5-3.5 percent in 2007, according to the Economic Research Service (ERS) of the U.S. Department of Agriculture.

The sustained low inflation is attributed to technology, increased efficiency in managing inventories and assortment and relentless competition. Food retailers today include conventional supermarkets, superstores, supercenters, membership clubs, combination (food and drug) stores, natural and organic outlets, limited assortment stores, convenience stores, dot-coms and gasoline stations. Consumers have never had more choice in variety, value, nutrition and quality. Many of these retailers emphasize low prices to gain a competitive edge.

Food Costs Continue Half-Century Decline

Even more telling is the decrease in the portion of family income spent on food (Figure 2) — freeing up funds for other purchases. That figure continues to decline steadily to only 9.9 percent today — down from more than 20 percent a half century ago. In 2005, consumers spent 5.8 percent for food-at-home and 4.1 percent for food-away-from-home.

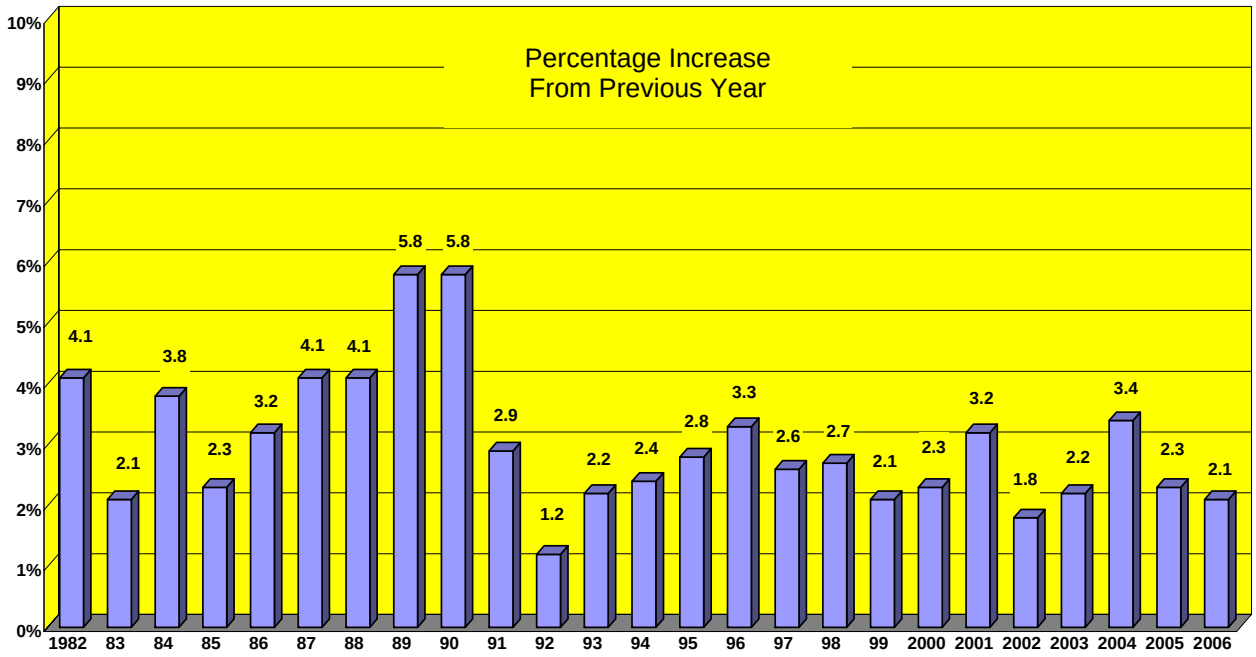
U.S. consumers spend less of their income on food than people in any other country, including people in industrialized nations such as France (14.9 percent), Italy (14.9 percent) and Spain (17.1 percent). Families in China (26.4 percent), Russia (28.5 percent) and Indonesia (55.1 percent) spend a lot more.[1]

Farm Value and Retail Food Prices

Consumers spent $788.9 billion for food that originated on U.S. farms in 2004, according to the most current ERS data. About 20 percent, or $155.5 billion, went to farmers (farm value) and the remaining $633.4 billion (marketing costs) covered all the expenses to bring food to consumers — including labor, processing, packaging, storage, displaying, marketing, advertising and interest. The total marketing bill includes food-away-from-home sales — the cost of highly processed restaurant meals.

The farm value varies widely by commodity, depending on factors such as the amount of processing required between the farm and retail food store. Egg producers

Figure 1. More Than Two Decades of Low to Moderate Food Inflation

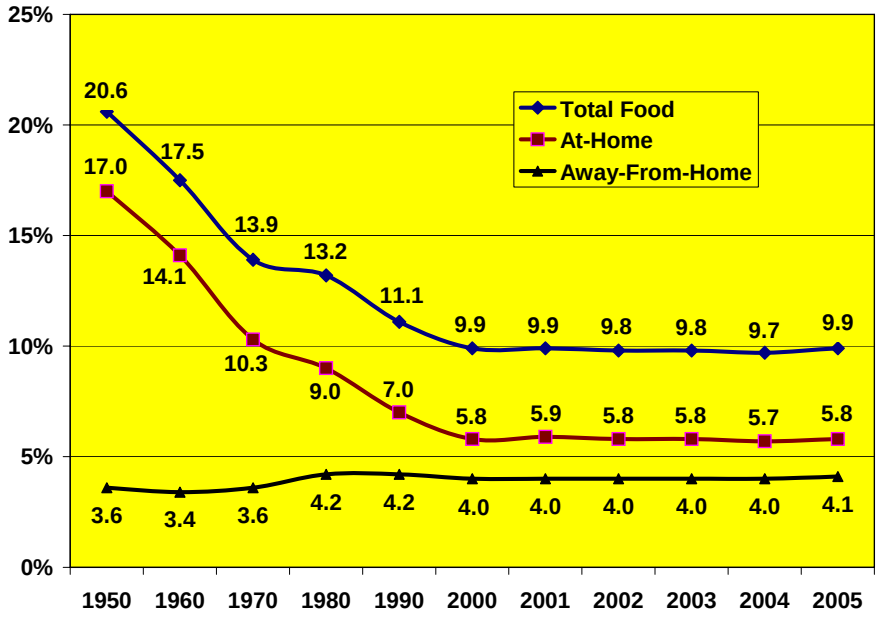


Sources: U.S. Bureau of Labor Statistics and the Economic Research Service of the U.S. Department of Agriculture.

receive a larger portion of the retail dollar than do wheat growers because bread requires extensive processing.

The prices for food, as with all consumer products, are subject to the laws of supply and demand. When costs for key commodities rise because of reduced supplies or when inflation boosts marketing costs, food prices tend to climb at a faster rate than overall consumer prices. When costs for key commodities fall, consumer prices will follow, as long as the marketing costs remain steady.

Figure 2. Percentage of Family Income Spent on Food



Note: Some figures do not add up due to rounding.
Source: USDA Economic Research Service

Competition significantly affects prices as well. Over the past 15 years, the rapid growth of discount retailers — including supercenters, warehouse club stores and limited-assortment outlets such as Save-Al-Lot — has helped keep overall food inflation low.

To compete with these discounters, other retailers enhance consumer service and add prepared meals, ethnic items, organic products and fresh fruits and vegetables, significantly increasing the assortment of foods available to consumers. This competitive response increases labor and other operating costs. Labor alone accounts for more than 60 percent of supermarket operating costs, putting upward pressure on the prices these retailers must charge. Recent increases in construction costs add to this pressure.

Food Economics From Farm to Shelf

Agricultural conditions also cause swings in food prices. Farm supplies and prices can change rapidly due to changes in weather, global competition and livestock growth and production cycles.

Changes at the farm level do not affect retail food prices immediately. Usually there is a time lag — from weeks to months — before cost changes appear on the retail shelf because most foods must be processed and transported before they are ready for sale.

For example, if a drought in California reduces the lettuce harvest, putting upward pressure on prices, a week could elapse before the increases show up at the retail level in Eastern cities. It takes time to transport the lettuce and move the higher-cost lettuce through the distribution system. Processed foods can experience a longer time lag. Retail bread prices, for example, may not reflect higher or lower wheat costs for months. ■

[1]ERS, Food CPI, Prices, and Expenditures: Expenditures on Food, by Selected Countries, 2004 (http://www.ers.usda.gov/Briefing/CPIFoodAndExpenditures/Data/2004table97.htm).

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