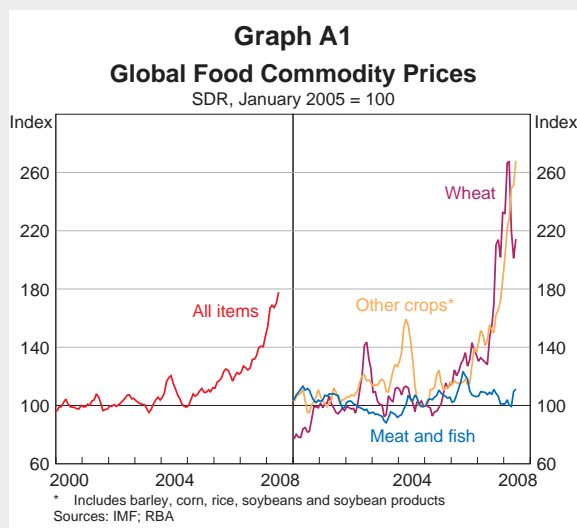


Box A: Global Food Prices

After a period of relative stability earlier this decade, the prices of a number of globally-traded food commodities have increased significantly over recent years.¹ Despite substantial falls in a number of grain prices in recent months, the IMF global food price index is around 80 per cent higher than in early 2005 and 35 per cent higher than a year ago (Graph A1). The increases have



been mainly concentrated in cereal grains (wheat, corn and barley), rice and soybeans. In contrast, meat and fish prices have been relatively flat. While the strength in crop prices can be attributed to a combination of both supply and demand factors, which have resulted in global stocks falling to very low levels, the relative importance of supply factors may have been somewhat underestimated.

Growth in global consumption of many grain crops slowed significantly over the 1960s, 1970s and 1980s, with average trend growth rates declining from around

4 per cent per year in the early 1960s, to a little below 2 per cent in the early 1990s.² Since then, however, trend growth in average crop consumption has stabilised at a little under 2 per cent per year.³ As would be expected, over time trend crop production growth generally moves closely with consumption. However, since around the beginning of the current decade, the gap between production and consumption has widened, to be the largest it has been on a sustained basis for at least 40 years. While this has been most pronounced for wheat – growth in production has been around ½ percentage point below trend growth in consumption – there have also been gaps between production and consumption for other crops to varying degrees (Graph A2). As a result, the level of crop stocks (as a ratio to use) is at, or relatively close to, its lowest in 40 years. While it is difficult to be definitive, the weakness in growth of wheat production this decade looks to have been primarily the result of an increase in weather-related disturbances, with

1 It should be noted that while the recent increases are significant, in real terms current prices are 20 per cent below the 1980s average, with food prices having fallen in real terms for many decades – see ‘The Recent Rise in Commodities Prices: A Long-Run Perspective’, April 2007 RBA Bulletin, pp 1–9.

2 Simple average of wheat, corn, rice, barley and soybeans. Trend growth is calculated using the Hodrick-Prescott filter.

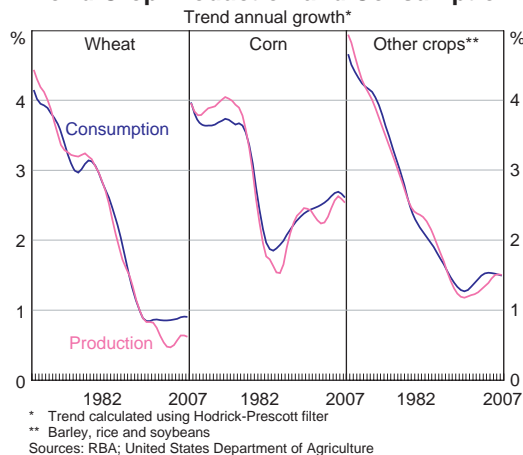
3 The slowdown in the growth of demand for grain crops has been primarily driven by developments in industrialised economies, where population growth has slowed and demand for foodstuffs is inelastic. This moderation has to an extent been offset since the 1990s by stronger demand from the developing economies.

global production actually falling in three of the eight harvests so far this decade. Consistent with this, growth in crop yields slowed to only 1 per cent in the past five years – less than half its long-run average pace – as production faltered despite a rise in area planted. This suggests that supply disturbances have been a significant factor underpinning the tightening in grain markets over recent years.

Several additional factors have also exerted upward pressure on prices, with the effects amplified by tight markets. US-dollar-denominated

prices have been boosted by the depreciation of the US dollar. More fundamentally, farmers have faced a significant increase in production costs, with fuel and fertiliser prices (both major components of the cost of production) increasing significantly. Higher energy prices have also prompted substitution towards bio-fuels,⁴ increasing demand for grain, with the impact most pronounced for corn and soybeans. While bio-fuel use of these crops remains relatively small, demand for bio-fuels has been growing rapidly, with the production of ethanol taking around 20 per cent of US corn production in 2007 (10 per cent of the global crop), and slightly more than one-third of the global increase in corn production over the past five years. Many analysts have also attributed part of the increase in grain prices to increased financial trading of these commodities. However, on balance it appears likely that speculative trading has only been a marginal influence, with the rise well explained by fundamental factors. ↗

Graph A2
World Crop Production and Consumption



⁴ Increased bio-fuel use has in large part been driven by government policy changes, with over 40 countries implementing policies to encourage usage in recent years.