

Food price rises impacting Asia Pacific consumers

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Food prices have risen sharply since October 2007 on international markets, owing to supply shortages. This is particularly affecting basic staples such as rice, wheat, grain and soya, which form much of the staple diet of lower-income consumers in the Asia Pacific region. Rising food prices will have negative implications for consumers in Asia Pacific, in terms of higher prices for basic foodstuffs and the eroding effect of rising inflation on consumer purchasing power. Falling consumer spending will be negative for business profits.

Key Points

• The price of some basic foodstuffs rose by more than 100% in the first half of 2008 with wheat, rice, soya and grain the worst affected;

• A major reason behind these price rises has been an abrupt disruption to food supplies, with a series of floods in Bangladesh and India in 2007 and 2008 seriously damaging rice crops;

• Increased demand for food from fast-growing populations such as China is also pushing up prices;

• In addition, growing demand for biofuels is reducing the land available for agricultural production, reducing food output;

• Rising food prices are reducing consumer disposable income, while some of the poorer sections of society are unable to purchase sufficient food;

• This is particularly negative for low-income rice-dependent countries in the region such as Bangladesh and Myanmar, with low-income sectors in India and China also suffering;

• Higher fuel prices are also increasing the cost of food, since it now costs more to transport it and to run agricultural machinery.

Higher food prices, combined with surging oil prices are pushing up inflation and eroding consumer purchasing power further;

Government responses have been divided between imposing quota limits on agricultural exports and allowing interest rates to rise to curb inflation.

Background

The Asia Pacific region is one of the major producers of basic foodstuffs. Nine of the world's top ten rice producers are based in the region: China, India, Indonesia, Bangladesh, Vietnam, Thailand, Myanmar, the Philippines and Japan (in order of magnitude). Some wheat and soya is also produced, particularly in India and China. Rice is one of the major and hitherto cheapest foodstuffs in the region, making up approximately 40% of daily calorie consumption. For the poorer sections of society it can account for 30-40% of spending. Therefore, sharp price rises will have a major impact on the population and particularly on poorer consumers. Businesses will suffer from lower consumer spending, although food-exporting companies will benefit from higher global prices.

Supply shortages

The sharp food price rises in the first half of 2008 stem from a number of factors:

Environmental factors have reduced crops, particularly of rice. For example, Cyclone Sidr in Bangladesh in November 2007 destroyed approximately 80% of the rice crop, reducing international and domestic supply.

In addition, severe floods in India in October-November 2007 destroyed rice and corn crops, while heavy rainfall in early 2008 also damaged rice fields in China;

A longer term factor is that yields of rice are decreasing. The International Rice Research Institute estimates that average yield growth in South Asia fell from 2.1% per year in 1970-1990 to 1.4% in 1990-2005. There are several reasons behind this. One is that many countries may have reached maximum production capacity and are utilising all possible farmland;

• Also, the ongoing industrialisation of countries such as India and China means that fewer people are working in the

agricultural sector, reducing potential yields;

In addition, dietary changes are shifting food demand trends. For example, as incomes rise in countries such as China and Thailand, consumers are substituting meat and dairy for traditional rice consumption. This is pushing up demand for the grain required to feed the livestock;Â

Demand for rice is increasing in non-traditional markets such as Latin America and Africa, owing to its cheapness and dietary versatility.

Demand for basic foodstuffs is outstripping supply, pushing prices up. While this will have some positive impact on businesses and workers in the agricultural sector, the majority of consumers will suffer from rising prices.

Impact of rising prices

Food prices have risen sharply, in some cases by more than 100%:

International prices for rice rose by approximately 74% between January and June 2008, while prices for wheat, soya and corn rose by 130%, 87% and 31% respectively over the same period;

Â Domestic prices have risen less sharply, owing to subsidies and export restrictions in many countries. For example, Bangladesh has introduced subsidies, while China has introduced export restrictions;

Â However, government subsidies cannot absorb all the price rises and so domestic consumers are experiencing a loss of purchasing power. The Bangladeshi government estimated in May 2008 that the poorer population were spending as much as 70% of their incomes on basic foodstuffs, primarily rice;

Â This is a reversal of recent trends by which expenditure on food as a proportion of total expenditure had been falling in line with rising incomes. For example, in 2007, expenditure on food as a percentage of total consumer expenditure in India was 30.9% compared to 36.9% in 2002;

Â Rising oil prices are also eroding consumer spending power, both directly and through increasing transportation and production costs of food. The price of oil reached US\$135 per barrel in late June 2008;

Â While some agricultural businesses are reaping profits from higher food prices, in general businesses are suffering from a downturn in consumer spending.

Inflation increases

Rising food prices are also pushing up inflation, as are high fuel prices:

Rice and grain are core components in inflation calculations. Inflation in India reached 8.8% in May 2008, a seven-year high. China's inflation reached 7.7% in May 2008, a slight fall from record highs of 8.5% in April 2008, while inflation in Bangladesh reached a high of 10.1% in March 2008 (last data released);Â

Rising inflation will push up prices for other goods. This will erode consumer purchasing power further, with related negative implications for business profits, particularly of goods classed as luxury or non-essential;

Shortages of rice and other basic foods are having an impact on other regions, particularly low-income countries in Africa, although these regions are generally less reliant on rice than Asia Pacific.

Government responses

Several governments have attempted to ease the income shock for consumers:

Countries such as India, China and Vietnam have since early 2008 attempted to limit exports of rice in order to increase supply and push down domestic prices;

Measures include introducing a tax on exports. For example, in March 2008 India increased the minimum export price for basmati to US\$1,200 per ton, from US\$1,100 per ton. Exports of non-basmati rice were banned entirely;Â

In early 2008 China imposed a 20% tax on wheat exporters and a 5% tax on rice and corn exporters. No expiry date has been set;

In addition, the Bangladeshi government introduced subsidies for rice following Cyclone Sidr, although these were removed in June 2008 as the government could no longer afford to absorb the differential between the subsidised and market rates. The cost of rice in Bangladesh has therefore risen to 30 taka per kg, compared to the subsidised rate of 25 taka per kg;

Governments are also seeking to combat inflation by allowing interest rates to rise. Higher interest rates will weigh on consumer spending potential by reducing access to credit and making loans more expensive;

However, governments will have to be careful not to raise rates too much, since this would depress consumer spending and weigh on economic activity. Businesses would also find it harder to access loans as well as suffering from lower consumer spending;

Many interest rates therefore remain in negative territory, with inflation rising higher than rates can keep up. Consumers therefore suffer doubly, from higher interest payments and inflation-related erosion of spending potential;

Governments are suffering from subsidising food and fuel, as well as aid programmes. Pressure on fiscal budgets will weigh on economic growth, as will falling consumer spending. For example, Bangladesh's fiscal deficit is forecast to rise to 5.0% of GDP in 2008, up from 4.8% in 2007;

Economic growth in the region will moderate as a result of rising fuel and food costs. For example, in low-income countries such as Bangladesh and the Philippines, 2008 growth rates are forecast at 5.5% and 5.9% respectively, down from 5.6% and 7.2% in 2007.

Future scenarios

Economic growth in Asia Pacific is forecast to decline to 5.4% in 2008 from 6.5% in 2007. Immediate food supply shortages should ease in the second half of 2008:

• Rice harvests in mid-2008 should ease some domestic and international pressure. For example, Vietnam is forecasting a bumper 2008 harvest and has stated it may resume exports from July 2008;

International aid is also providing some support for low-income consumers. The US pledged US\$770 million in aid to countries most affected by food shortages, while the World Food Programme is running programmes in Asian countries particularly affected by drought and shortages;

However, this prolonged period of high food and fuel prices will have a negative impact on economic growth, even in the region's strongest performers - Chinese and Indian growth will decline in 2008 to 9.3% and 8.0% respectively, from 11.4% and 9.2% in 2007;

However, long-term supply constraint issues remain, such as the decline of the agricultural sector and dietary changes, ensuring that demand will continue to outstrip supply;

Ongoing climate change indicates that flooding will become increasingly common in Asia Pacific, threatening future harvests;

The ongoing development of biofuels will also keep food costs high, by putting pressure on land resources;

Governments have not yet begun to invest in improving food supply, although the Chinese government has stated that it hopes to improve food self-sufficiency;

Moreover, even if food prices decline, inflationary pressure will still impact on consumer incomes, since it will take at least six months for the impact of higher interest rates or lower prices to feed through to affect prices.

Food price growth will slow in the second half of 2008 but is unlikely to fall greatly. The impact on consumers will be generally negative, with long-term factors ensuring that rising food prices will continue to eat into disposable incomes.

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