

THE OUTLOOK FOR FOOD PRICES

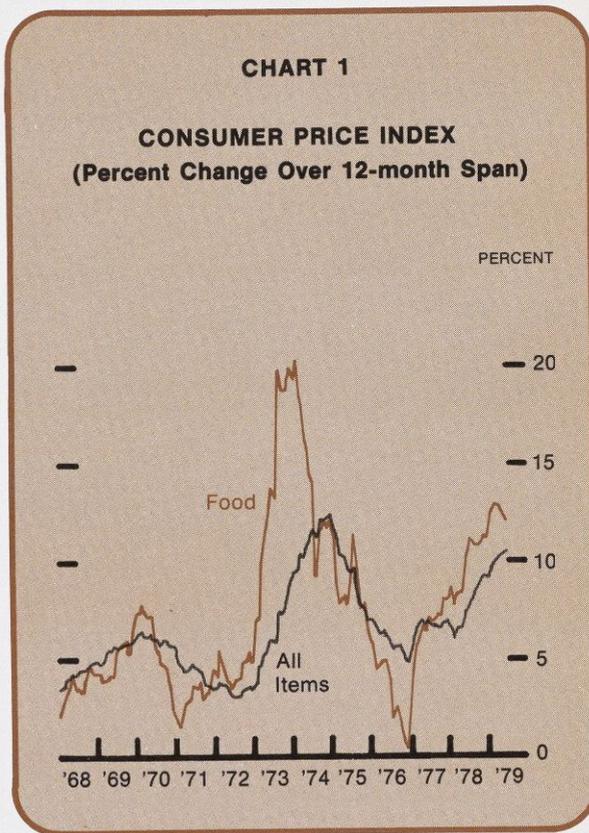
by Gene D. Sullivan

A major continuing problem in the national economic outlook is inflation. During 1978, food prices were a prime contributor to the rapid rise in inflation. Many projections have indicated that climbing food prices will continue to be troublesome in 1979, and the data confirm that large increases occurred in the first quarter.

Forecasting food prices is a hazardous business. Past forecasts often have not sparkled with accuracy. The errors have not been entirely attributable to the incompetence of forecasters. Food prices result from a complicated set of influences and interrelationships, not all of which are foreseeable at any given time. Unusual weather has often been a major disruptive force that cannot be taken into account in advance.

Here, we hope to provide insight into a number of major factors that influence food prices. Specifically, we will (1) show the relationship between changes in food prices and changes in the Consumer Price Index; (2) compare the importance of food prices to other expenditure groups making up the CPI; (3) examine and compare the major components of food expenditures; (4) project price changes for these major components; and, finally (5), project the price change in the food component of CPI in the year ahead.*

Reports of price data so often mention food prices as a major cause of price inflation that one might expect that the consumer



price level is largely determined by retail food prices. That, however, is not the case.

Chart 1 compares percentage changes in food prices and the overall Consumer Price Index from 1968 forward. Food prices are clearly more volatile than the index for all items, having risen a great deal more rapidly at times and considerably more slowly at other times.

*Both the content and format of this article reflect heavy borrowing from a presentation made at the November 1978 Agricultural Outlook Conference by Dr. J. B. Penn, economist with the U. S. Department of Agriculture. We have adjusted the price forecasts in areas where our opinions differ from Penn's and where subsequent information has led us to different conclusions.

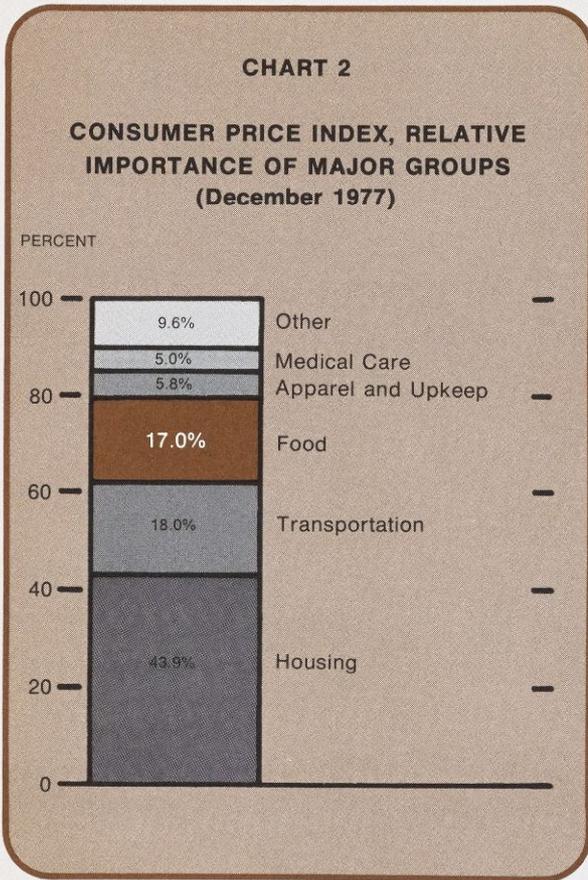


Chart 2 shows the relative importance of food and other major components of the CPI. Housing accounts for nearly 44 percent of the total, and food, at 17 percent, ranks in third place. Thus, food prices account for less than one-fifth of the CPI.

Chart 3 depicts the components of food expenditures and reveals that the value of raw farm commodities (domestically produced) accounts for 26 percent of the total. The cost of marketing services accounts for over half of food expenditures. The remainder, 17 percent, is spent for foods of foreign or nonfarm origin.

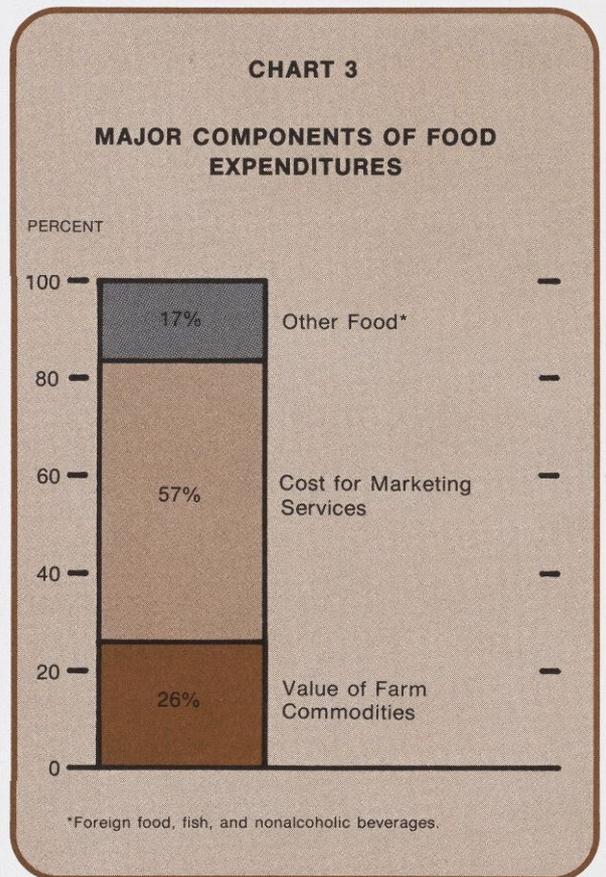
Marketing services exert the major influence on food prices. As shown in Chart 4, labor is the largest single component of marketing services, with packaging and transportation charges making up smaller identifiable segments. Insurance, financing, advertising, and overhead charges comprise the relatively large category labeled as "other" expenses.

Labor and transportation costs are expected to increase most rapidly in 1979. Labor

costs will rise an estimated 10 percent. Workers receiving wages of \$4 or less per hour, who are exempt from the Administration's wage restraint program, are prevalent in food retailing. Retailing, including eating and drinking places, accounts for three-fourths of all production workers involved in processing and marketing food. Therefore, labor costs in the food sector are likely to advance faster than in the rest of the economy.

Transportation costs are strongly influenced by energy prices. Recent announcements of price increases for imported petroleum products lead to expectations of rapid rises in transportation costs, perhaps as much as 15 percent in 1979. Packaging costs, also heavily dependent on oil prices since a number of food products are packaged with materials derived from petroleum, may be expected to increase about 10 percent this year.

The high cost of inventory financing is likely to maintain at least an 8-percent rise



in other marketing costs in the year ahead. Thus, if we weight these projected price increases by their shares of total food costs, we can expect marketing services to contribute about 5.5 percent to the total rise in food prices in 1979.

Important components of raw farm commodities are shown in Chart 5. Meats and livestock products account for the lion's share of the total. Crop products, including fruits and vegetables, claim a relatively small percentage of total food outlays. Fruits and vegetables were a major source of food-price inflation in early 1978, but more plentiful supplies of all crops in 1979 are expected to hold down price increases for food crops in the year ahead.

The major threat of increased food-price inflation comes from the livestock sector. A continuing shortage of meats is expected to result in rapid price inflation that will spill over to all livestock products as

CHART 4

**MARKETING SERVICES
(57% of Food Expenditures)**

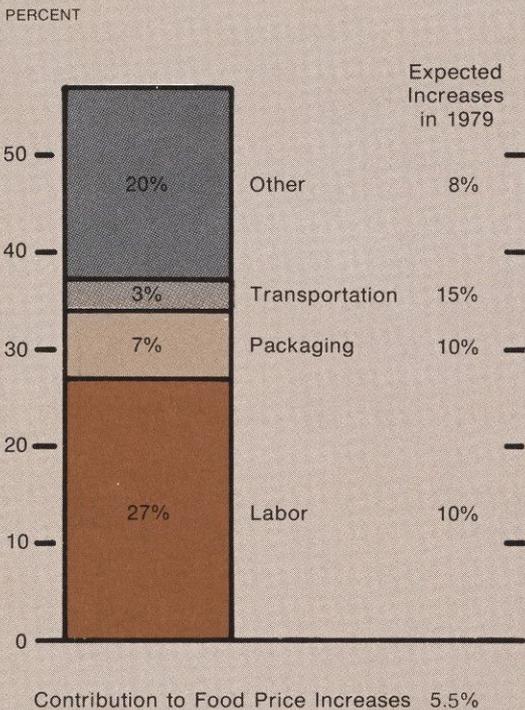
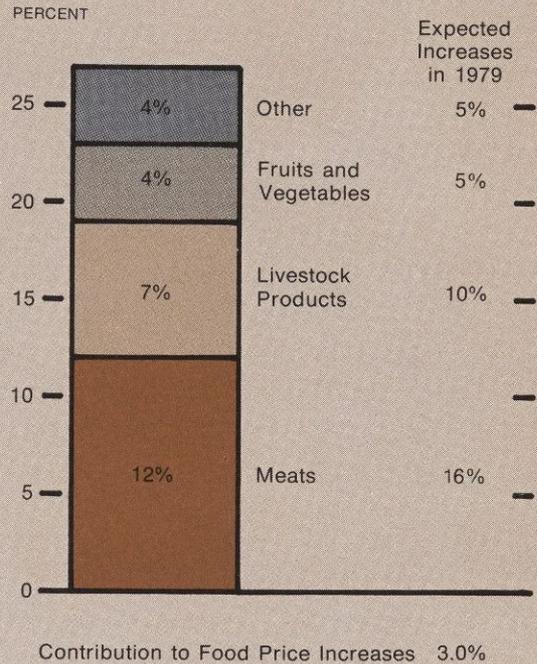


CHART 5

**RAW FARM COMMODITIES
(27% of Food Expenditures)**

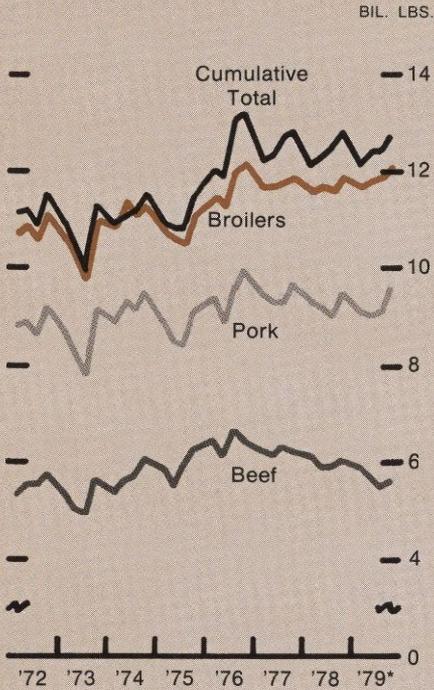


consumers attempt to substitute eggs and dairy products for high cost meats. The combined impact of inflation in raw farm commodities is expected to add 3.0 percent to the boost in food prices in 1979.

The shrinking meat supply (see chart 6) is primarily attributable to the liquidation of cattle herds that farmers began when prices plunged in 1974. However, recent surveys show that pork producers will boost pork output by 15 percent during the second half of this year. That will counteract the expected further decline in beef production, but even with broilers and other types of meats added in, 1979's total meat output is still unlikely to reach the level that occurred during 1976 at the height of the liquidation of cattle herds. With consumer demand continuing to rise rapidly in the face of stable or dwindling meat supplies, rapid price increases are the way the market equates supply with demand.

CHART 6

U.S. COMMERCIAL MEAT PRODUCTION



*Estimated.

**SOURCES OF FOOD PRICE INCREASES
IN 1979**

	<u>Percent</u>
Raw Farm Commodities	3.0
Marketing Services	5.5
Other Food Products	1.5
Total Expected Increase	10.0

The table shows the summation of the expected food price increases during 1979. Marketing services will contribute 5.5 percent, raw farm commodities will add 3.0 percent, and other food products are likely to account for another 1.5 percent. The total projected increase amounts to 10.0 percent. That is higher than the USDA's most likely forecast, but it is below the rate that may result if weather problems should again severely restrict crop output.

The long-run hope for bringing food-price inflation under control is expanded meat supplies. Prospects for increasing meat output are assessed in the next article appearing in this issue. ■