

## **Prices & Outlook: Fall 2005 Retail Food Prices**

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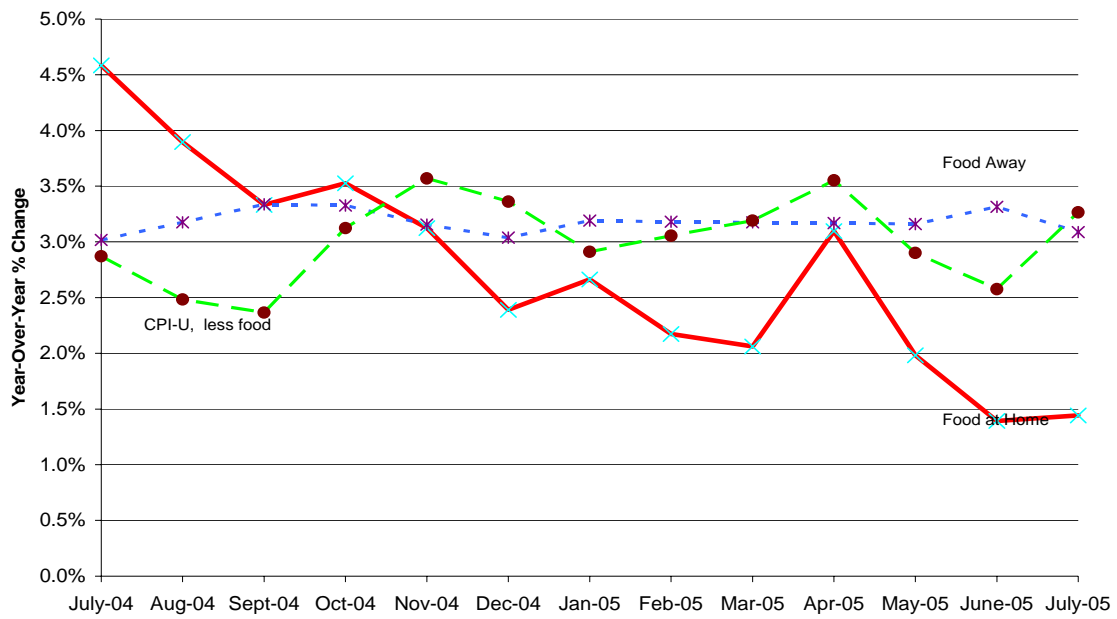
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Faced with sharply higher gasoline and energy prices, food shoppers will see some relief at the grocery stores. The food price increases in 2005 are much smaller 2004 due in large part to abundant supplies of many food products that had been in short supply last year due to events such as the weather-related damage to fruit and vegetable crops (Hurricanes Andrew, Ivan and Jeanne), the import restrictions on beef due to the evidence of Bovine Spongiform Encephalopathy (BSE) in the Canadian and U.S. herds, and a smaller egg-laying flock. A second factor in the smaller food prices increases is the increased competition and downward price pressure exerted warehouse stores and supercenters that are capturing a larger share of the food retailing sector.

Grocery store prices rose 1.4% from July 2004 to July 2005, a much smaller increase than last year's rise of 4.8% (figure 1). This food price increase is well below the 1995-2005 average annual food and beverage retail price increase of 2.5%. This food price increase will be less than the energy price increase of 14% and the 2.1% non-food-and-energy consumer price rise.

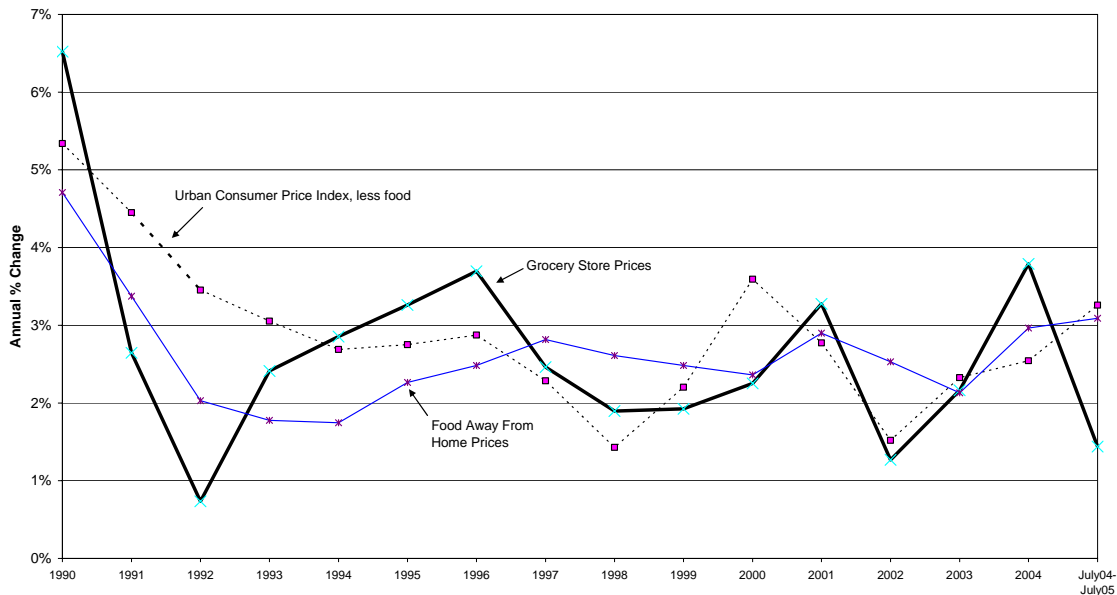
Grocery store prices have increased at a steadily falling rate over the last 12 months, and by July restaurant food prices and non-food prices were rising twice as rapidly as prices for food at home (figure 1). The USDA estimates that grocery store price increases will be in the 2.5-3.5% range for the rest of 2005 and for 2006, which is twice the rate of core inflation. Moderating farm prices will be largely offset by rising food marketing costs. Restaurant prices are expected to increase at the same pace for the rest of 2005, and then more slowly in the 2-3% range for 2006.

**Fig. 1. Retail Food Price Changes,  
Year-over-Year Annual Rates, By Months, 2004-2005**



To place the current food prices in a historical perspective, this grocery store price increase is very small (figure 2). Generally grocery store prices increase annually at 2 percent or higher and over the last 14 years only 1992 and 2002 have seen price increases this small. In contrast, non-food goods and restaurant prices are increasing at the typical pace of 3% over the last year.

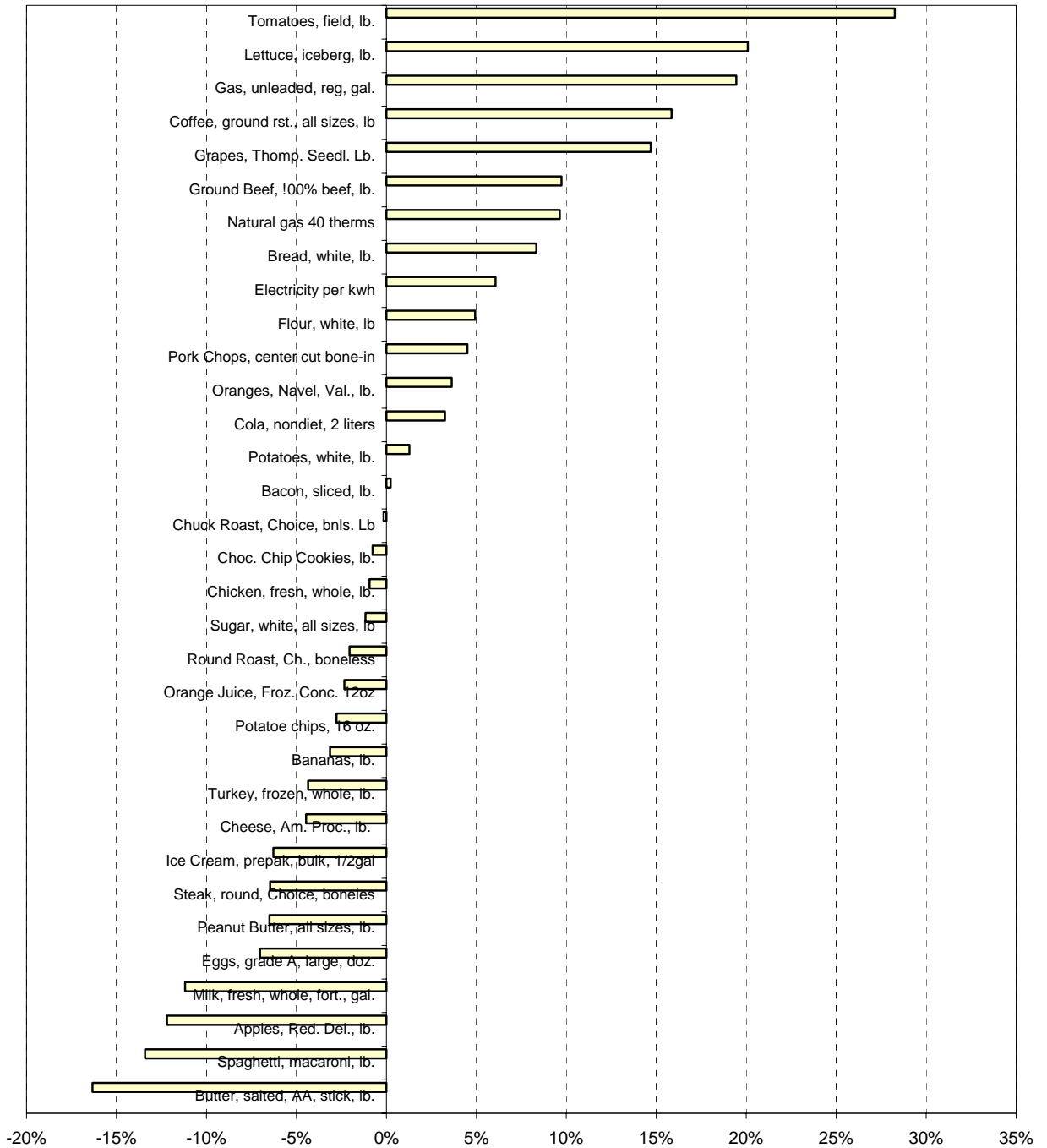
**Fig. 2. Retail Food Price Trends, 1990-2004**



Rising prices over the last 12 months have been lead by the energy sector with gasoline prices up 20%, natural gas up 10% and electricity up 6% (figure 3). Many of the food product prices have fallen. The most dramatic retail price decreases are occurring in the dairy and egg sectors that had record high prices last year with a 16% decrease in the price of butter, an 11% decrease in the price of milk, and a 7% decrease in the price of eggs. The largest food price increases have been for fresh tomatoes, lettuce, coffee and grapes. For the fresh fruits and vegetables, these prices increases are due in part to increased demand and to cool spring whether that has affected production in Florida, California and Mexico.

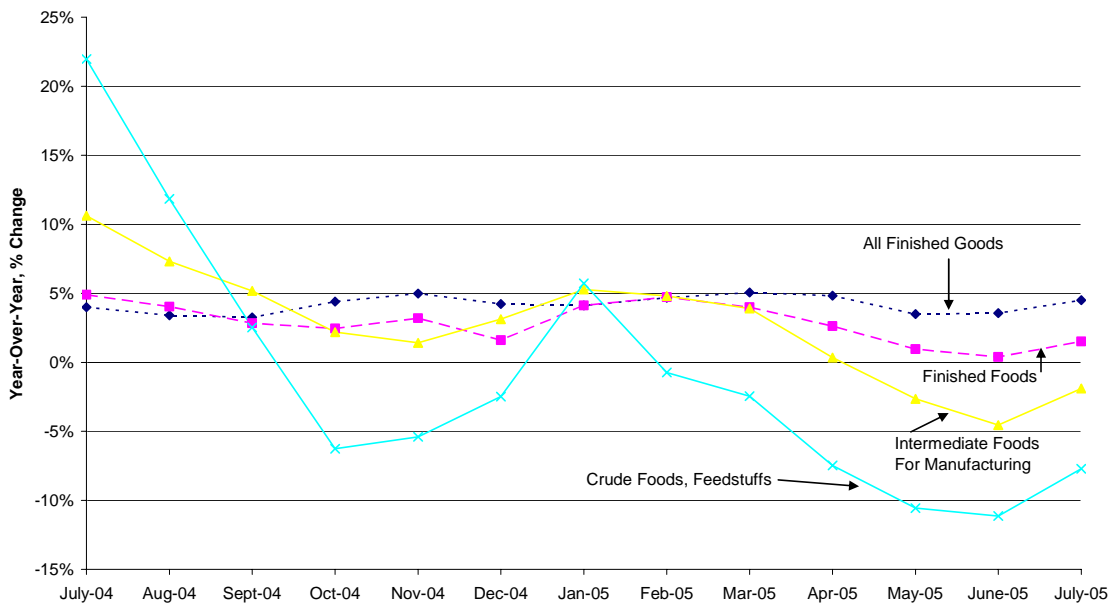
Looking to 2006, there are three forces that may have a major impact of food demand and therefore prices. First, the popularity of the “low carb” or high protein diet appears to be in serious decline as evidenced by the bankruptcy filings of Atkins Nutritionals. Combined with the US/Canadian border opening potentially opening to cattle imports, a decline in beef prices is expected. Second, the revised Dietary Guidelines for Americans and revised USDA Food Guide System (i.e. food pyramid) were released in the past year and there are 2 significant changes from the 2000 guidelines: increase consumption of whole grains and decrease consumption of sugars. Third, starting in 2006, the nutrition label will also report the content of trans fats. Currently, food production companies are reformulating their products to reduce the content of trans fats. Even New York City has asked its restaurants to stop using trans fats in cooking.

### Fig. 3. Retail Food Prices: Percentage Changes, July 2004 to July 2005



While many factors determine retail food prices, the dominant factors in the coming year will be energy costs and ingredient costs. Energy prices have been increasing and ingredient costs have been decreasing, making this a challenging environment in which to forecast food prices. The intermediate food products for manufacturing have been falling all year, led by year-over-year decreases in crude foods and feedstuffs, especially grains, eggs, dairy and sugar (figure 4). As a result of these cost decreases, the wholesale prices of finished foods have increased only minimally at 1.5%, a much smaller increase than the 5% cost increase for all finished goods. Wholesale food prices are expected to be moderate next year with finished food prices rising 1.5-3%.

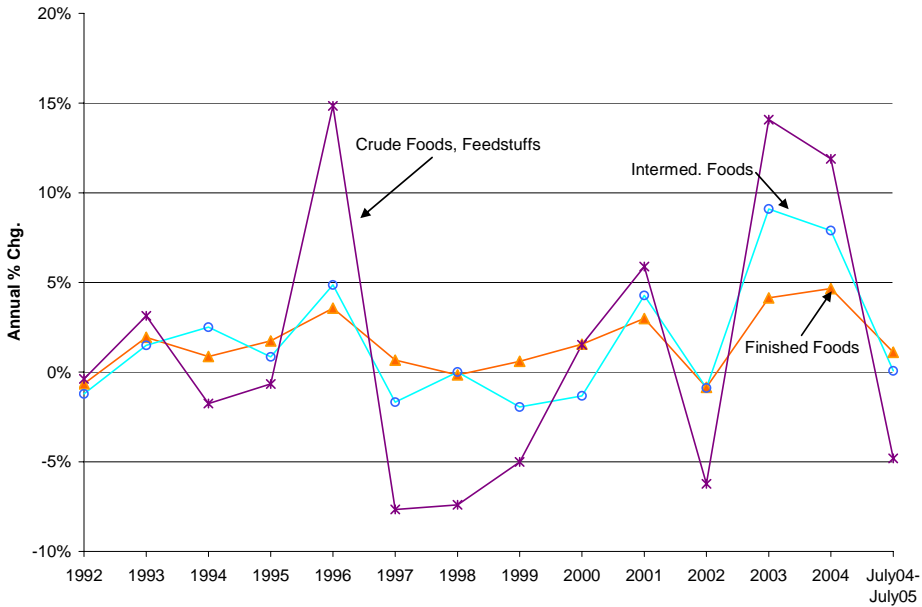
**Fig. 4. Producer Price Indexes for Food, Year-over-Year Annual Rates, By Months**



Currently, food companies are benefiting from substantial cost decreases in food ingredients and as a result the increase in the wholesale cost of food has been very small (figure 5). Food companies have passed some of these decreased costs on to consumers, mostly by maintaining prices or raising food prices at a slower rate. Food companies have also been able to increase their margins. Looking forward, food companies will continue to face price pressure and pressure on their margins from supercenters, warehouse stores and depending on the strength of the economic recovery, consumers may resist price increases.

The farm-retail spread has been increasing from a 20-year low in 2003 to 3% in 2004, and well over 4% in 2005 (figure 6). A rising farm-retail spread means that the farmer is getting a smaller share of the consumers' food dollar. Food marketing costs increased 2% in 2004, and despite the increased price of energy, food marketing costs are increasing at the same pace in 2005.

**Fig. 5. Producer Price Indexes for Food, Annual Percentage Changes, 1992-July 2005**



**Fig. 6. Annual Percentage Change in Food Marketing Costs and the Farm-Retail Spread, 1981-July05**

