South Africa's food price inflation could soften in the coming months

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It sometimes feels like there is little more to discuss regarding South Africa's consumer food price inflation. The local crop data continue to show that there are ample domestic supplies on the back of large harvests in field crops and horticulture, which would have ordinarily led to a decline in prices.

Still, the question that repeatedly comes out in discussions with various stakeholders in the food industry is the impact of higher global prices on the domestic food market and whether this is the reason local prices have remained elevated in the face of a large harvest. This is an important consideration because the price developments we have witnessed in South Africa's soft commodities prices, specifically grains, in recent months reflect spillovers from the global market. This begs the question of where global grain prices are likely to go from here and how this could affect South Africa.

Before getting into outlook for global grains, let us recall that South Africa is typically a net exporter of maize and is therefore well integrated into global markets. My rough calculations, using high-frequency data (daily data with more than 300 observations), shows that the correlation between domestic and international maize prices remains positive, about 60% for white maize (which is mainly traded into the African region) and 85% for yellow maize (which is traded into the global market). This implies that when global maize markets increase, domestic maize prices rise in tandem. Importantly, for wheat, rice and soybeans (and other vegetable oils), where South Africa is typically a net importer, the correlation between domestic and global prices is stronger.

Against this backdrop, the recent report that the FAO Global Food Index averaged 127.1 points in May 2021, which is the biggest month-on-month gain since October 2010 and about 40% higher on a y/y basis would worry the local food industry stakeholders. This sharp increase was underpinned by a surge in prices for vegetable oils, sugar and cereals along with firmer meat and dairy prices, all of which South Africa is generally exposed to in the global market. The downgrade of production prospects in Brazil, dryness in parts of the US, the expected lower palm oil output in Southeast Asia, and the rising Chinese demand for grains, meat, dairy and oilseeds have been the primary drivers of prices these past few months.

But the data released at the end of May by the International Grains Council (IGC) suggests a change in the global grains supplies outlook in the 2021/22 production season. Firstly, the cold temperatures that had slowed plantings in parts of Europe have abated and plantings have now improved. Secondly, the US received beneficial rains, which improved the crop conditions and supported the plantings of the new crop. Lastly, the weather conditions in Ukraine and China have improved and supported the planting of the grain.

As such, the IGC forecasts the 2021/22 global maize production at a new peak of 1,2 billion tonnes, up by 5% year-on-year (y/y). Nevertheless, the stocks could slightly down by 2% y/y to 261 million tonnes because of firmer consumption in the global feed industry, primarily supported by China. Notably, the improved weather conditions and production prospects in the aforementioned regions could slightly soften the commodity prices, albeit not to levels seen last year because stocks are still set to be relatively low. Notably, the ongoing lack of clarity about the Southern Hemisphere crop (particularly in South America), which will only be planted in October, is another major source of uncertainty.

Similarly, the global wheat production conditions have improved. The IGC now forecasts 2021/22 global wheat production at a record 790 million tonnes, up 2% y/y. The global stocks for the same year are at 288 million tonnes, up by 1% y/y. These improvements point to a possible softening of global wheat prices in the coming months from the current highs. The global rice supplies and stocks are also at comfortable positions, well above the 2020/21 production season. We see a similar pattern in global soybeans production prospects, with 2021/11 harvest estimated at 383 million tonnes, up by 6% y/y. Meanwhile, stocks are estimated at 51 million tonnes, up by 10% y/y.

These production forecasts suggest that global crop prices from June going forward could soften slightly from the recent months' levels. That could also influence the South African consumer food price inflation outlook. However, the price developments in the case of soybeans will be influenced more by Chinese buying decisions and the broader vegetable oils market developments. The critical point is that global crop conditions are in a better state than in the past few months, which should be reflected in prices in the coming months.

The unique factor to South Africa, which stakeholders in the food industry will have to monitor consistently, is the impact is the biosecurity challenges. The most recent announcements of the foot and mouth disease in parts of KwaZulu-Natal and the ban of South Africa's beef in various export markets is one such disease to monitor, along with the African swine fever and Avian influenza. While these diseases are damaging and costly for farmers, they tend to lead to a decline in domestic meat prices due to the ban in exports, subsequently bode positively for local consumer food price inflation in the near-to-medium term.

Overall, these are all developments that I continue monitoring. Based on the expected sizeable domestic harvest, the expected softening in global grains prices, and recent developments in the meat industry, we are inclined to believe that South Africa's consumer food price inflation could ease from the second quarter of the year. Hence, I, for now, maintain a view that consumer food price inflation will likely average around 5,5% y/y in 2021.

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