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FOOD PRICES. Slim pickings

Food prices worldwide have been rocketing. SA, though shielded to some extent, is now heading the global route. **Shannon Sherry** looks at what is driving prices and who benefits along the value chain.

The crunch is coming. Food prices are at their highest since 1990. The UN Food & Agriculture Organisation food price index rose above the 200 mark for the first time in January and has stayed there for the first quarter of the year.

"The big cost drivers are the input sector, such as fertilisers. Oil companies are making huge profits" - JOHN PURCHASE

Even in the dark days of the "global food crisis", in 2007/2008, real prices were lower. Though world food prices in March were almost 3% lower than in February (the peak), they were still 37% higher than a year ago.

SA has been shielded marginally from higher world food prices by its huge grain surplus and relatively strong currency. Food price inflation in SA is at about 5% compared with most other countries' 30%-35%, and about 60% of local households are said to be food-insecure.

But it is expected that SA will eventually feel the full might of the global situation. Absa agribusiness head Ernst Janovsky agrees that SA cannot escape higher food prices. "I can only see that food prices will increase. It's definitely coming. Though we are being helped by the strong rand, I see food price inflation increasing to 12%-15%."

This picture is beginning to emerge in the latest producer price inflation numbers released last week.

SA's prices at the factory gate rose to 7,3% year on year in March (from 6,7% in February), fuelled by higher commodity-related prices. Analysts believe that input price increases, such as rising diesel costs, packaging and wages will filter through the food supply chain during the year, contributing to CPI food price inflation pushing to around 7,5% by year-end.

As always, the situation is driven by supply and demand: world food stocks are generally down and the global population is growing, expected to reach 9bn by 2050. The huge populations of emerging giants such as China, India, Brazil, Russia and others are also becoming wealthier, causing changes in their food-consumption patterns. They are eating more and differently, with animal protein - generally meat - topping their list. There is, therefore, far greater global demand for the food we need.

In the next 10 years, food expenditure in China is expected to rise by 50%, in India by 78%, and in developing Asia, the Middle East and North Africa by 40%.

But what is driving high food prices now? The soaring oil price is a double-edged sword in that it increases production and transport costs, and is also an incentive for more intensive biofuel production, increasing pressure for land.

In SA, the land-reform process is hampering agricultural production (see story on page 38), and there is no legislation enabling biofuel production. But in the EU, the US and Brazil, the production of biofuel consumes a huge amount of potential food. About 10% of the world's grains already go to fuel, including 35% of the US's maize and half of Brazil's sugar cane.

This has been happening for years, and some say that supply chains will adjust to allow for it. But production for food remains under pressure, and a supply shock or two means a crisis is not far off.

High food prices make for instability and volatile politics, and scapegoats are often sought when such crises arise. Consumers and even governments accuse players of manipulating prices, profiteering or hoarding, and fingers are pointed at various links in the food value chain.

So who profits from soaring food prices? The latest PPI figures show at agricultural level (the farmer) prices fell 0,9% year on year in March, but at manufacturing level food prices ticked up 2,9%.

Andre Jooste of SA's National Agricultural Marketing Council (NAMC) says the food business is a "low-margin, high-volume" one, meaning players in the value chain have to move lots of food to make a profit.

Agricultural Business Chamber CEO John Purchase agrees. "Farmers are under pressure and, if you look at the annual statements of food companies and agribusinesses, you will see that they make about 6% on investment. The big cost drivers are the input sector, such as fertilisers. Oil companies are making huge profits."

Though there have been well-documented cases in SA and other countries of price collusion by producers of food products such as bread and milk, margins have generally remained low. The NAMC, a government body which advises the minister of agriculture, has conducted a number of credible value-chain studies that make the point.

Two interesting studies involve investigations into the maize-to-maize meal chain and the wheat-to-white bread chain - which yield surprisingly different insights. Regarding the maize-to-maize meal chain between 2003 and 2010, it was found that the farm-gate price in real terms increased 40%, to R1392/t, over the period.

The mill-door price in 2010 was almost 47% higher than in 2003, at R1285. (The mill-door price is typically lower than the farm-gate price because millers derive extra income from the sale of "chop", a byproduct of the maize-milling industry which is sold as animal feed.) In the process of turning maize into maize meal, a chain of costs are incurred.

According to the study, between 2003 and 2010 transport costs from the farms to grain silos rose by 222% to an average R168/t. The costs of handling, grading and procuring at the silos, which price in a fee for a 1% physical loss, rose by 470% - from R25/t to R117/t.

Jooste says though the fees seem high, SA silos - mainly owned by agribusinesses such as Afgri and Senwes - compare favourably with those in other countries in respect of charges. These charges helped to raise spot prices for white maize on the SA Futures

Exchange to R1679/t, 53% more than in 2003.

Average costs incurred by millers also rose: storage and handling increased by 123%, to R55/t, and transport costs from silos to mills went up by 82%, to R102/t. Millers' incomes from the sale of chop were almost 40% up, at R423/t.

Further comparisons in the manufacture of maize meal show that about 63% of the grain is extracted as maize meal - 1t of grain therefore makes about 630kg of maize meal. The rest goes to animal feed.

This brings the average selling price of meal for efficient millers to R3419/t. In supermarkets it sold at an average R4117/t - 39% up on 2003. It means millers and retailers share in a margin of R698/t - less than 70c/kg - testimony to Jooste's "low-margin, high-volume" description of the food business.

Independent, off-the-record inquiries by the FM confirmed the very low margins on "pap" among retailers, which said their policy was to not discuss margins on individual products. Retail margins vary slightly on the size of pack and, in some cases, also in areas with differing levels of affluence. One of the big four supermarkets, which refused to be identified, claimed its margin on maize meal never went over 2% in township stores and not more than 7% in affluent areas.

A similar study on the wheat-to-white bread chain (see tables) showed that last year retailers made 90c on each 420g loaf sold. Bakers and millers made between 7c and 79c a loaf, depending on their efficiency levels. And, at an average selling price of R7,88/loaf, government's 14% Vat levy on white bread was 97c/loaf - a bigger slice than the retailer's.

Packaging costs for bread have increased 120% since 2002, and production and maintenance costs by 317%. Costs of distribution (100%) and overheads (198%) have also risen since 2002. This has all resulted in a 140% increase in the cost of a loaf of white bread between 2003 and 2010.

Primary food producers - farmers - have also faced steep increases in costs. Fertiliser, fuel, animal medicine and treatment, feed, maintenance and repairs and crop protection have all risen. Fertiliser and fuel are the biggest contributors to the production costs of field crops.

SA imports most of the fertiliser it uses and the cost is highly sensitive to the oil price, international demand (especially in the US and China), and global stock levels. Fertiliser prices fell sharply after their 2008 highs, but are showing signs of rising strongly again. Fuel contributes hugely to agricultural production costs, as well as to the distribution costs of food, especially in a country like SA.

Jooste points out that transport costs are often mistakenly taken to mean fuel costs, but they are broader than that. Between 2004 and 2009, the capital cost of trucks increased by 8% for two-axle vehicles, 31% for six-axle vehicles and 28% for seven-axle vehicles. Their running costs - including fuel, oil, maintenance, tyres and incidental costs - rose by 75%, 78% and 109% respectively.

Fixed costs - including depreciation, licences, insurance and labour - were respectively 11%, 31% and 26% higher. These are the vehicles most used to transport agricultural products and livestock.

But when all the costs of getting food to consumers are considered, it is clear that "food inflation" might be a misnomer. All the inflationary pressures in the economy flow into the price of food, as does the relative strength of the currency, which is helping SA keep its head above water - but not for long. Andre Jooste.