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Recent Trends in Food Prices

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Introduction

Food price increases constitute a major source of economic difficulty, both in the short or long term. In Bangladesh, general price levels have a tendency to keep rising, indicating some inflationary bias in society. Although inflation in itself is not always a worrisome indicator, a rising rate of inflation is a different matter. Price increases, especially on food items, reduce disposable income of the poor households and pose a great burden, because of the higher total share of food expenditure among poor households. From the extreme poor to the middle-income groups, many have to sacrifice on non-food items, usually from the essential consumption basket. The rise in food price levels has been found to create 25% welfare losses in Bangladeshi households, when prices rose by 50% during 2007-08[1] . Since spending on food constitutes a large share of the consumption basket, price changes in which is tracked by inflation metrics, food price fluctuations can dictate general price levels in society and create inconveniences for all citizens.

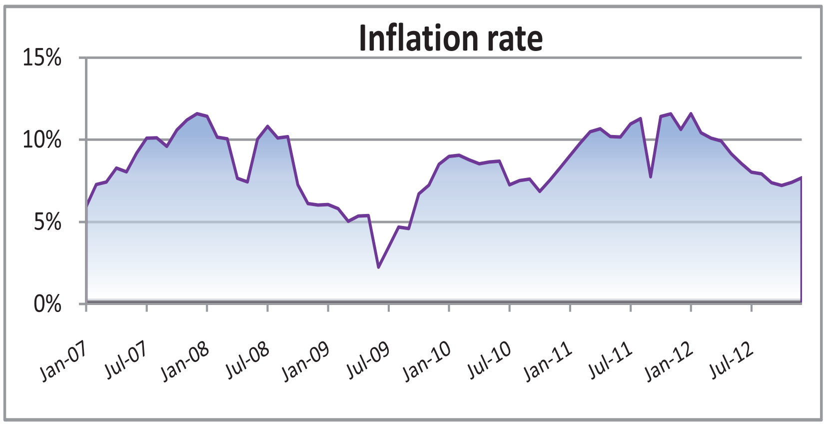
In the last several years, food prices have undergone some volatility. Global food prices have been declining, falling 14% between August 2014 and May 2105. As an outcome of global food price decline, food inflation in Bangladesh also came down earlier this year. Even at the time of prolonged hartals, which caused disruptions in supply chains, food inflation did not reach worrisome levels. Recently however, food inflation saw monthly fluctuations between April 2015 and September 2015.

It has to be pointed out that volatile global commodity prices are not inevitably reflected by food inflation statistics. Overall, however, price escalations globally do cascade down to markets in Bangladesh, albeit not always proportionally. This current event analysis piece will consider factors at work that affect food prices and impact thereof on average food price levels.

Bangladesh inflationary trends

Inflation rose steadily from around 2% during FY 2000-01 to as high as 11.41% in FY2011-12. It rose due to consistent rise of global fuel and food prices until 2007, registering a steep 11.59% in December 2007. It fell sharply to 2.25% in July 2009, due to the global economic recession of 2008-2009. As the global economy recovered, so did prices of international commodities. Consequently, the rise of inflation from that point onwards was reflected in Bangladeshi prices as it returned to a high of 11.58% in November 2011[2] . Ever since, it has moderated, once again reflecting world commodity prices. Figure 1 shows a trend of point-to-point inflation.

Figure 1: Bangladesh Historic inflation

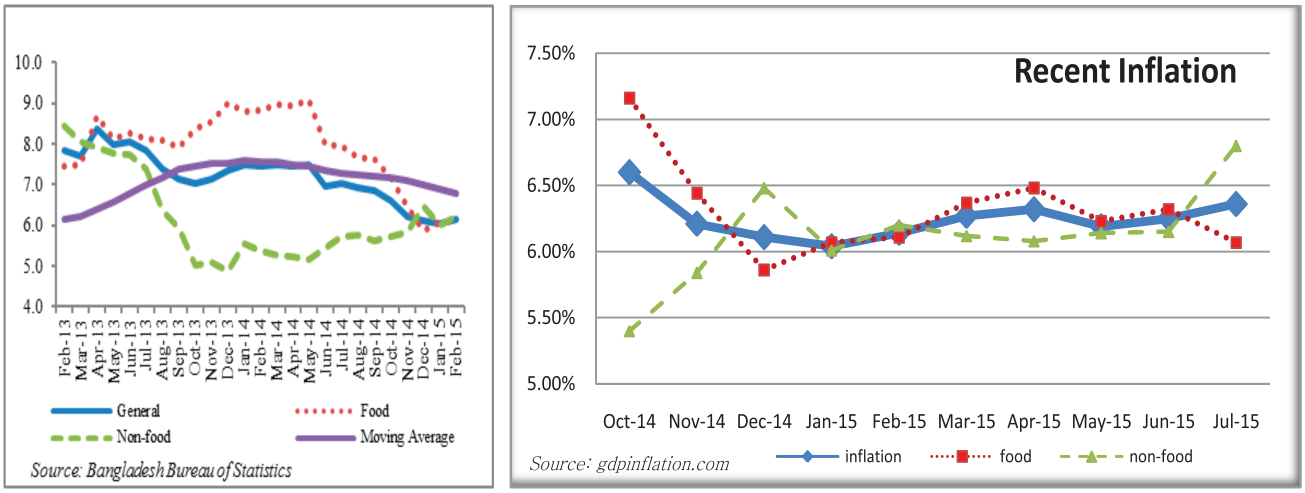


Recent trends

Since 2012, inflation has been well regulated through a mixture of prudent monetary policy, fiscal policy and foreign exchange accumulation. Since mid-2014, inflation began to fall, while the Bangladesh Bank exercised a watchful monetary policy by placing ceilings on private sector credit growth. Point-to-point inflation dropped to 6.04% in January 2015, which was a 26-month low, from October 2012. A 3-month political unrest from January claimed as much as 1% point of GDP[3] and ended the decline. The economy stabilized thereafter, saw a rising 12 month point-to-point food inflation in April. This reached 6.48% during “Pahela Boishakh” (Bengali New Year), which is marked by spending sprees. Subsequently, inflation slowed to 6.23% in May. It rose once again to 6.32% in June, which coincided with the month of Ramadan. Sellers of commodities, despite possessing significant inventories, sold them at 60-120% higher price levels in the major cities, with price differences between wholesale and retail markets ranging from 50 to 100%.[4] Following Ramadan, food inflation fell very close to 6% levels. In August, onions experienced significant price volatility for a week[5] and other commodities were also sold at varying inflated prices. Around the same time, torrential rains flooded cropped lands in 30 districts in the country’s southeast and southwest. The monsoon rains affected 20% of 87 thousand hectares of vegetable farming fields. This short-time phenomenon, however, did not raise the overall food inflation significantly. Major drivers affecting food price are detailed in the next section.

In addition to food inflation, non-food inflationary pressures are also common in the Bangladesh economy. Major drivers of non-food inflation, at least recently, have included political turmoil, garment factory closures, public salary increment speculation, changing power prices, and a depreciating euro, which affects exports. Disparity between food and non-food inflation can also contribute to inflationary trends. That said, the dominance of food inflation with respect to headline inflation rate is pronounced. Food inflation tends to lead overall inflation levels in Bangladesh, owing to the large share of food commodities in the CPI basket.

Figure 2: Bangladesh Recent food and non-food inflation



Proponents of price movements

- *Macroeconomic policy changes and depreciation:* Changes in banking, interest and exchange rates have impact on inflation. To cite two examples, an expansionary monetary policy in 2009, aimed at bolstering foreign trade, or taka depreciation in 2011 (by 15%), both of which had the effect of making import costly, had led to non-food inflationary pressures. Policies adopted by the government to rein in food inflation include reduction of import duties, provision of credit to food importers and expansion of the public food distribution system. Credit disbursement for food cropping aid is monitored by the Bangladesh Bank, which sets targets for the same. Open market sale of food grain to the limited-income groups and Fair Price Card holder advantages help curtail food inflation.

- *Major festivals:* Festivals such as the two Eids and "Pahela Boishakh" have a strong impact on demand-pull inflation. Food and non-food prices both adjust upwards, as people celebrate through spending on food and clothing or through religious sacrifice of cattle, farmed locally or imported from India. These factors are significant and persistent predictors of price levels.

- *Ramadan:* The holy Islamic month usually entail spending-sprees in the economy. Food items such as meat, fish, oil, spices and especially vegetables have high positive price changes (in addition to escalating prices for non-food commodities). Not considering the low-inflation years of 2007-08 in Bangladesh's recent economic history, in most years, Ramadan has seen hikes in food inflation. The highest inflation point differences before and during Ramadan was posted in 2009, at 4.95% points; registering a rise in levels of 48%.[6] In 2015, inflation during Ramadan increased from 6.19% to 6.25%, while food inflation rose from 6.23% to 6.32%. Food inflation was also much higher in urban than rural areas,[7] where food consumption is higher. Ramadan is one of the seasonal drivers affecting prices.

Supply side mechanisms that cause price disparity

- *International prices of commodities and fuel:* In September 2015, non-food inflation rose to 6.73% while food-inflation declined slightly, in part due to government price adjustments to curtail subsidies on power and gas. Oil prices have been falling since mid-2014 to very low levels. Nonetheless, fuel-utilized power generation led to increase in prices domestically. This could have directly increased production costs of food, even if irrigation sector and fertilizer producers were exempted from the increased power and gas prices. Both fertilizer and irrigation have a significant impact on the domestic levels of food production. Irrigation promotes bumper crop production even during dry seasons, while HYV cultivation requires heavy fertilizer usage. Both irrigation and fertilizer usage require power and fuel inputs, hikes in prices of which increase production costs, translating into higher food prices for consumers. Meanwhile, the final impact of oil price drops is not clear on food price levels, although decline in production costs ought to be expected.[8] Direct imported food price hikes were also witnessed recently. Prices of imported onions spiked in August and September 2015, after the Indian government had set prescribed minimum prices. This led to temporary dislocations in domestic prices in Bangladesh.

- *Natural Disasters:* Every year, thousands of hectares of cropping land go underwater due to flash floods or large-scale floods. This typically restricts farming and food supply. Consequently, supply chain distortions ensue, and prices become highly volatile. Vegetables and paddy suffer as supply chain distortions in their markets tend to be the most acute. Transportation is also hampered, as floods lead to the damage and shutdown of major wholesale hubs of commodities. The 2009 cyclone Sidr affected 1 million hectares of cropping land, which created a shortfall of 3.4 million metric tons of rice.

- *Political Unrest:* Large-scale unrest and prolonged hartals have been recurring in Bangladesh in 2013-2015. A 3-month blockade in 2015 and several months of violence during the end of 2013 and early 2014 are noteworthy. As a result of hartals and blockades, supply chains become distorted, as transportation is impeded and businesses forced to slow down and in some cases, shut down entirely. Factory owners are forced to run their factories below–capacity, owing to a scarcity of raw materials, and retailers are forced to cancel orders. Apart from the highly affected service and export sectors, agriculture production is also very vulnerable to such shocks. Inter-district transportation is obstructed during hartals, which constitutes a severe hindrance across sections. In FY2015, it is believed that the political turmoil claimed at least 1% of GDP. Overall inflation also lowered due to a lack of effective economic activity.[9] Food inflation, however, due to supply shocks, rose during the hartal period.

- *Syndications:* Be it political, or simply operational, syndications are a major factor which contributes to food inflation. It deserves a separate section for discussion.

Syndications

Syndications refer to the process of hoarding supply, which ultimately leads to a shortage of commodities in the market. There are non-beneficial and sometimes beneficial syndicates. Syndicates may be created to determine domestic price changes to reflect international commodity or transport prices. Syndicates may also be borne out of local profit-motivations.

During international crises, syndicates may be brought about by intermediaries or middlemen; in some cases, result from a limited number of local food importers; and in other cases, be a consequence of a cartel of deceitful traders. Bangladesh periodically faces this situation, being a food-import dependent economy. When international price of a commodity drops, imports have already occurred at a previous higher price. For businesses to make up costs, importers sell at previous higher prices, higher than the recent lower global price.

Another channel through which speculation can lead to syndication results from rising international prices. Globally, when price hikes occur, domestic supply is compromised, since importers are reluctant to import at the higher international price. During such periods, domestic suppliers have a tendency to hoard. Domestically, prices tend to spike more compared to international levels. Importers then start importing in bulk and as a result of the increased supply, domestic prices slowly fall to prevailing international levels. Beneficial syndications also occur, albeit infrequently, when market syndicates utilize economies of scale. This keeps prices below higher international competitive prices levels. Syndication is normally a profit maximizing behavior, implying that syndicate forces are naturally motivated to sustain the market at the profit-maximizing price level.

Supply chain distortions exist whenever there is an extended supply chain between local and remote markets. Distortions may arise at different stages: during transportation; during processing and packaging; and in the handling of storable commodities. There are numerous roles adopted by specialized agents, which can significantly lengthen the supply chain depending on the market in question and the agents' respective levels of local and administrative clout.[10] Before reaching the final market, long delivery chains increase costs without little-to-no value addition. Such syndicates also create steep entry barriers to new players.

Conclusion

It is admittedly difficult to highlight predominant factors that influence commodity price levels. These factors vary depending on the time-period being considered. Demand side factors, frequently through seasonality and macroeconomic policies, and supply side factors, often via syndication, move prices up or down. Other minor factors may present themselves abruptly. That said, the factors in this report constitute the major drivers that impact headline food and commodity inflation.

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