

EAGLEs Flash

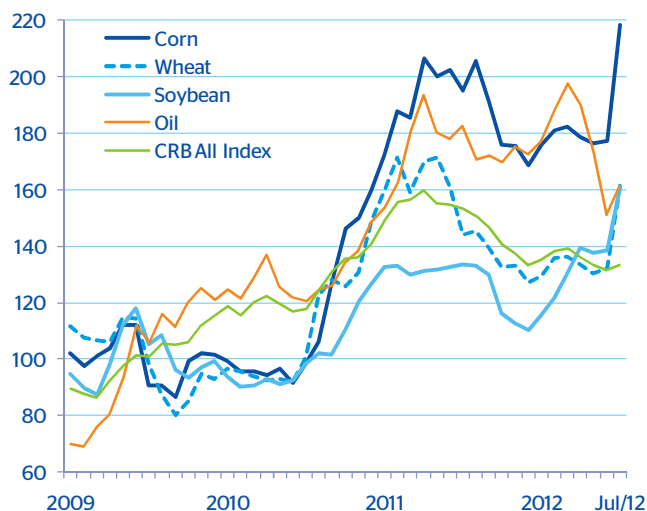


Supply shocks turn on again red light for food inflation

Corn and soybean prices climb to new records on the US drought while wheat is also hit by production cuts in other big players

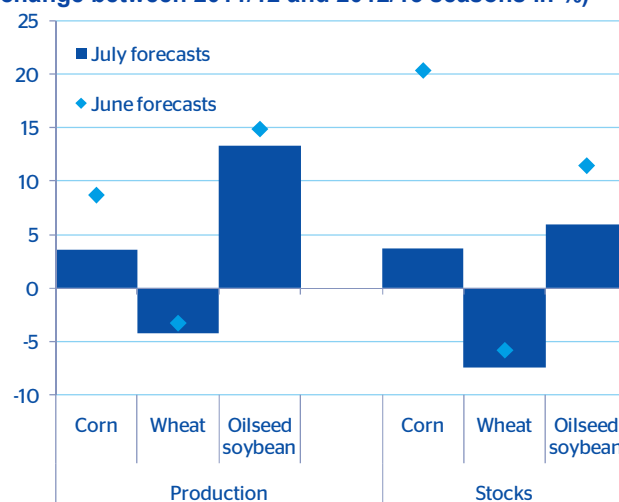
Commodity prices have been under downward pressures since mid 2011 due to a worsening global outlook, although corrections have been limited because of ongoing dynamism in emerging markets. However, this common picture was first broken in the oil market at the beginning of 2012 because of tensions between Iran and the West. Now, some markets of agricultural products are being supply-shocked (see Chart 1), especially by US droughts affecting around two thirds of the country¹. The US is the largest world producer of corn and oilseed soybeans with around a one-third share, while it is among the largest suppliers of wheat after the European Union, China and India. The latest July forecasts released by the US Department of Agriculture cut expected world production for the 2012/13 season by 5% in the case of corn and 1% for wheat and soybean with respect to June forecasts². The downward revision for the US account for the world correction for corn and soybean, while in the wheat market forecasts for other big players have been also recently cut down (Russia, China and Kazakhstan) and follow previous general downward revisions with respect to 2011/12 season (see Chart 2). With increasing consumption in the agenda, shifts in stocks expectations are larger in the corn and soybean markets, which present tighter conditions. The drought in South America at the beginning of 2012 had a significant impact on soybean production in the region. The situation in this sense is less tight for wheat, with an expected decline in demand and a higher stock with respect to consumption.

Chart 1
Selected commodity prices (index 100 = 2009)



Source: BBVA Research and Haver

Chart 2
World production and stocks forecasts (change between 2011/12 and 2012/13 seasons in %)



Source: BBVA Research and US Department of Agriculture

Large price shifts ready to deliver terms of trade gains and losses, press up inflation and stress the social situation in low-income countries

Besides the US, Argentina and Brazil are big exporters of corn and oilseed soybeans, Ukraine of corn and wheat, and Russia, Canada and Australia of wheat. Modulated by commodity export shares and trade openness, higher export revenues could be fuelled into monetary expansion and if not sterilized end up in inflation pressures. Besides, large producers could restrict exports in order to contain domestic prices, as it happened in Russia in 2010, eventually increasing pressure on international markets. On the other side, Japan and Mexico lead corn imports, China purchases two thirds of international soybeans, and finally Egypt is the top importer of wheat. In relative terms, imports are very relevant for those least developed countries

¹ See the Agricultural Weather and Drought Update at <http://blogs.usda.gov/tag/weather-update/>

² Production, supply and distribution statistics by the USDA are available at www.fas.usda.gov/psdonline/psdhome.aspx

mainly located in Africa and Middle East. In all these cases, a more expensive import bill directly impact domestic inflation conditioned by both the share in the consumption basket and government policies. In the case governments opt to absorb increasing commodity prices through subsidies, the fiscal position would then be the variable mostly affected³. And if budget doesn't (or can't) play a role diminishing price pressures on population then social unrest could be at risk depending on duration of the price shock, as it happened in previous years and as FAO representatives have recently pointed out⁴. All these spillovers would be of course amplified if recent shocks extend to other commodities and food items, such as livestock. Furthermore, additional shocks could be adding to the US drought as the monsoon rainfall in India is well below normal figures so far⁵ and China has recently experienced severe flooding. That is, adverse meteorological conditions for the two main rice world producers. In terms of monetary policy, if food inflation pressures spread they could blur even more the current uncertain scenario for central banks in emerging markets.

Álvaro Ortiz Vidal-Abarca
alvaro.ortiz@bbva.com
+34 630 144 485

David Martínez Turégano
dmartinez@bbva.com
+34 690 845 429

BBVA | RESEARCH



| Paseo de la Castellana 81, 7th Floor, 28046 Madrid | www.bbva.com

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³ Some references for MENA countries, including discussion about efficiency of food subsidies, could be found at www.imf.org/external/pubs/ft/survey/so/2012/car051412b.htm and <http://menablog.worldbank.org/how-exposed-are-mena-households-global-food-price-increases>

⁴ www.bloomberg.com/news/2012-05-07/united-nations-cites-risk-of-social-unrest-from-high-food-prices.html

⁵ Special daily weather reports are available at: www.imd.gov.in/section/nhac/dynamic/SPLNEW.pdf