

# Food and meat price inflation in the UK

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Consumers are experiencing their highest food bills for years. The era of cheap food appears to be at an end. Food manufacturers' increased raw material and other production costs are being passed onto the retailers who in turn are passing them immediately onto the consumer. In 2006 UK household expenditure on food was close to £62 billion. In the first half of 2007 food expenditure was up nine per cent in current prices. Even after adjusting for inflation, consumers spent four per cent more on food than in 2006. The second half-year's data will show an even greater increase.

This article looks at how average food prices have moved over the last ten years and in particular at the trend in retail meat prices. It then looks in more detail at food inflation in the last year or so and specifically those commodities that have driven the recent increase in price. An analysis of the input costs of food production so far in 2007 reveals a change in influence compared with previous years.

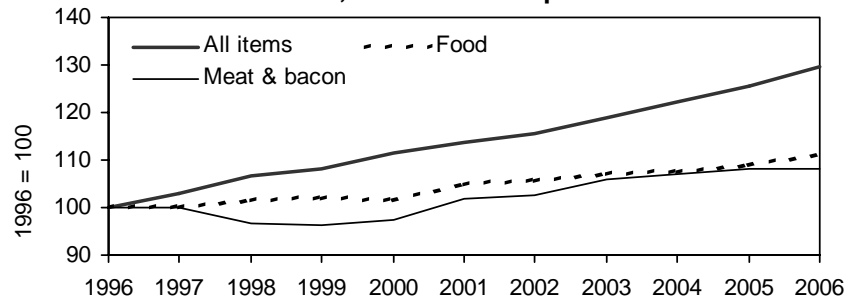
## Long-term retail price trends

The all items retail price index (RPI) is the most long-standing general-purpose measure of inflation. It is used for a variety of purposes by both government and external users, including the indexation of various incomes and prices and the uprating of pensions, benefits and index-linked gilts. In the 10

years between 1996 and 2006 the average retail price of food in the UK increased by 11 per cent. This was much less than the 30 per cent increase in the RPI. Over this period the largest price movement was in housing (+ 79 per cent), followed by leisure services which includes tourism (+ 53 per cent). In contrast, the average price of clothing and leisure goods, for example, toys, books and CDs, fell by 21 per cent and 25 per cent respectively. Between 1996 and 2006 the index of meat and bacon prices followed a similar trend to that of the all food index. In 2006 meat was eight per cent more expensive than 10 years earlier.

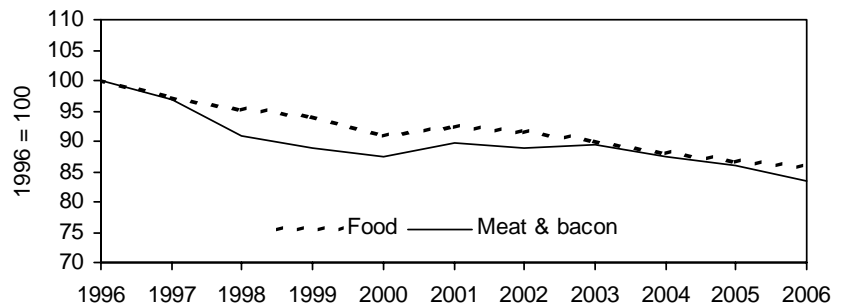
In every year since 1996, except for in 2001, the annual increase in the RPI was greater than the increase in food prices. In 2001 inflation was 1.8 per cent but food prices rose by 3.3 per cent. This was mainly the result of more than a four per cent increase in the average retail price of meat which reflected the shortage of domestic supply caused by the foot and mouth disease (FMD) in that year. In real terms, taking out inflation, food prices in 2006 were 14 per cent less than 10 years ago. The real price of meat was 17 per cent less than in 1996.

Index of all items, food and meat prices 1996 - 2006



Source: National Statistics, MLC

Index of deflated food and meat prices 1996 - 2006

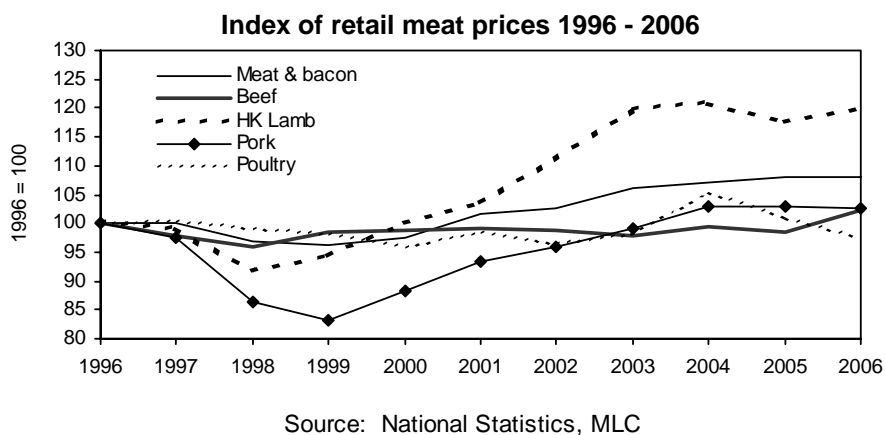


Source: National Statistics, MLC

## Increase in retail lamb prices much greater than other meats

The following diagram illustrates how over the last 10 years the average retail price of home-killed lamb has risen much more sharply than the price of other meats. In 2006 lamb was 20 per cent more expensive than in 1996. By comparison, beef was only two per cent dearer. A demand:supply imbalance in the aftermath of FMD resulted in a 16 per cent price increase for lamb between 2001 and 2003.

Between 1996 and 1999 there was a steep fall in the retail price of pork, caused by a strong upward trend in supplies of UK pig meat. Prices rose in the next few years, but between 2004 and 2006 they remained largely unchanged.

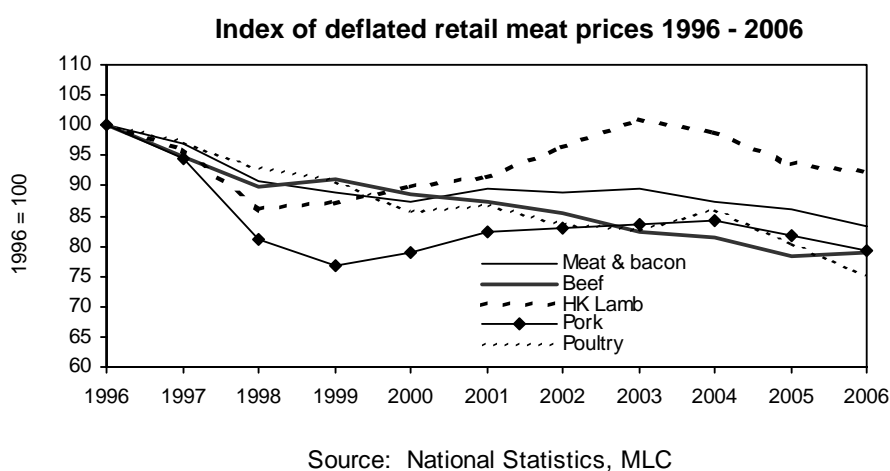


Except for in 2001, and again 2003 and 2004, the average annual retail price for poultry fell every year between 1996 and 2006. In 2006 poultry was more than two per cent cheaper than 10 years earlier.

After adjusting for inflation of around three per cent per year, the average annual retail prices for beef, pork and poultry in 2006 were between 20 and 25 per cent lower than 10 years earlier. In contrast, the real retail price of home-killed lamb was just eight per cent less than in 1996. In the period under review, lamb was the only meat whose average annual price rose faster than inflation. That was in 2003.

## Short-term retail price trends

Looking in more detail at developments over the last two years reveals a fundamental change in food pricing patterns. Increasingly since late-2006, food prices have risen at a faster rate than inflation. In April 2007 the annual rise in food prices was at its highest for over a decade. Food inflation was 5.6 per cent compared with overall inflation of 4.5 per cent.

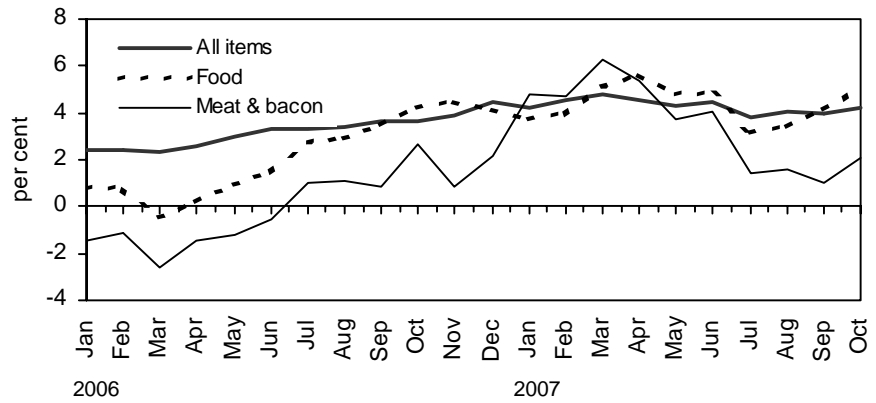


Whilst over the long-term meat inflation has been less than food inflation, in the first three months of 2007 the annual increase in meat prices was greater than the rise in overall food prices. To some extent this was a reflection of particularly weak beef, lamb and poultry

prices in 2006, but nevertheless bacon price increases of around eight per cent earlier this year did contribute to the overall rise in the meat price index.

The latest figures available at the time of writing show that, excluding mortgage interest payments, in October 2007, the annual increase in food prices of 5.2 per cent was second only to the annual increase in petrol prices of 11.7 per cent.

**Annual change in all items, food and meat prices  
January 2006 - October 2007**

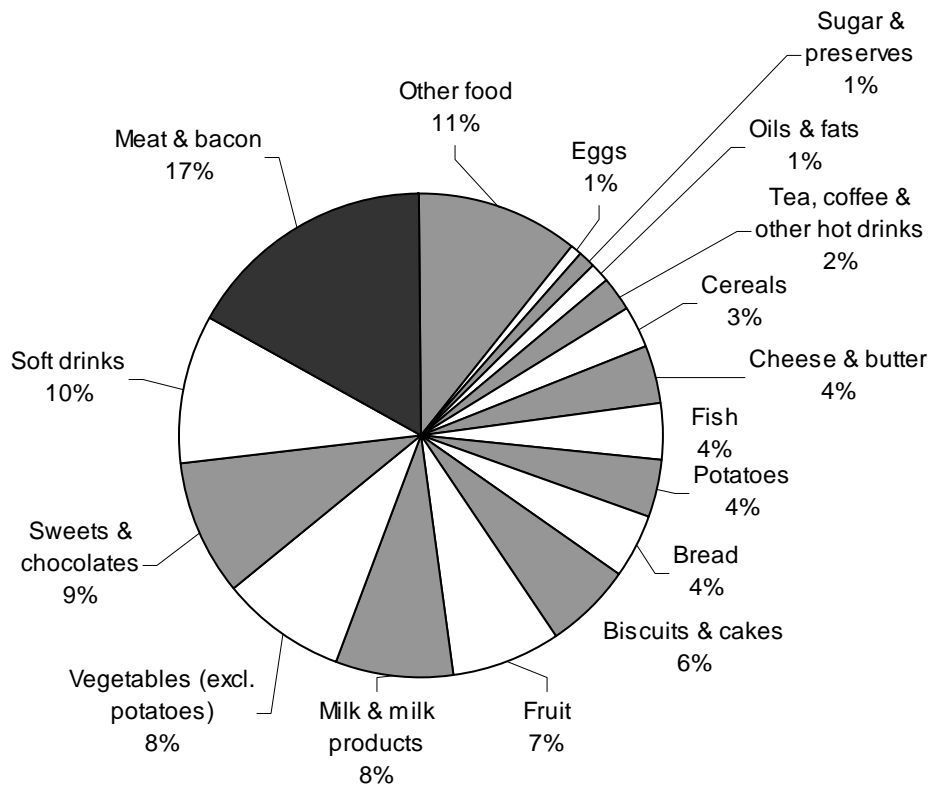


Source: National Statistics, MLC

### Influence of various commodities on overall food price increase

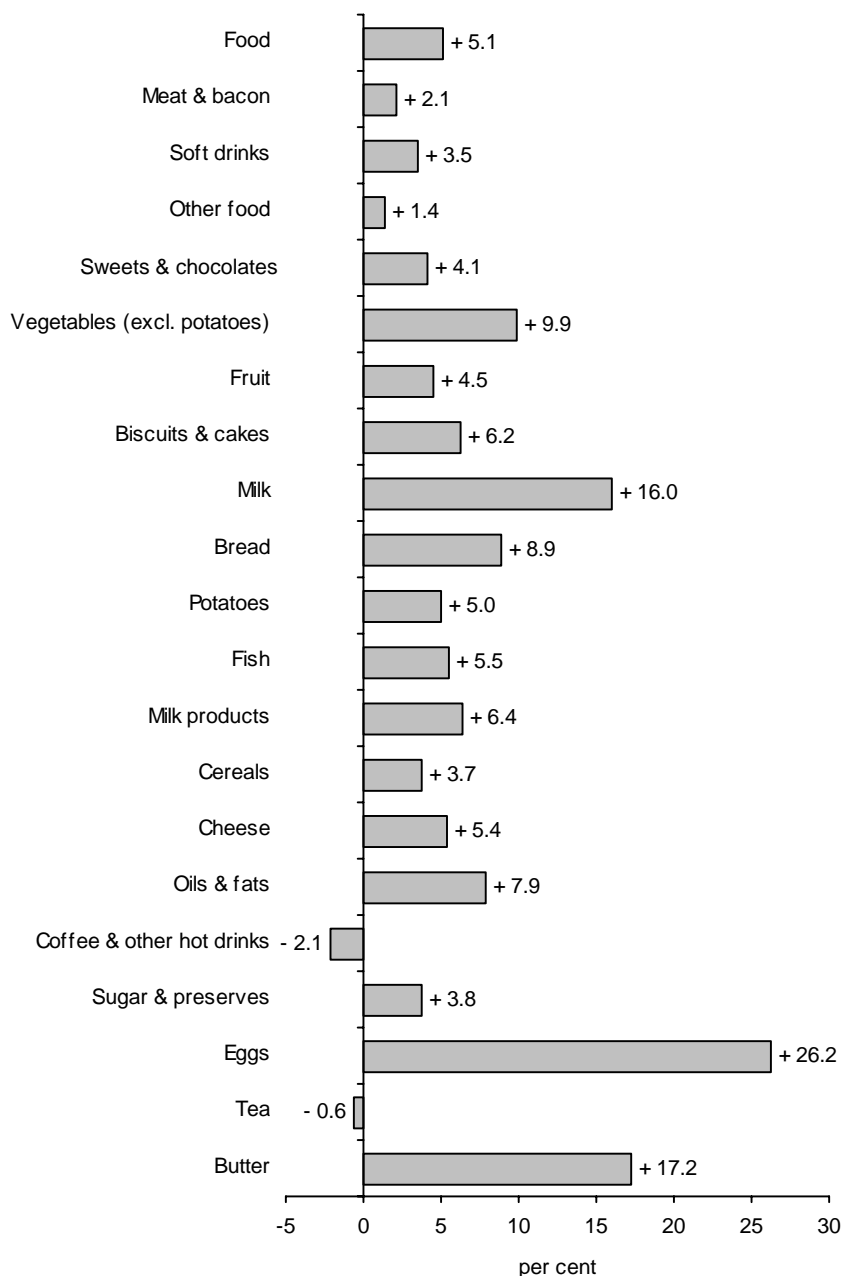
The food price index measures the changes from month to month in the cost of a representative 'basket' of food items. Each item in the index is weighted to reflect the proportion of household expenditure spent on the item. These weightings are reviewed annually. Meat accounts for the largest share of food expenditure and, therefore, has the largest weighting in the food basket at 17 per cent. Soft drinks have the next largest weighting. Oils and fats, sugar and preserves and eggs each have weightings of less than two per cent.

**Food basket weightings 2007**



Source: National Statistics

### Change in retail food prices October 2007/October 2006



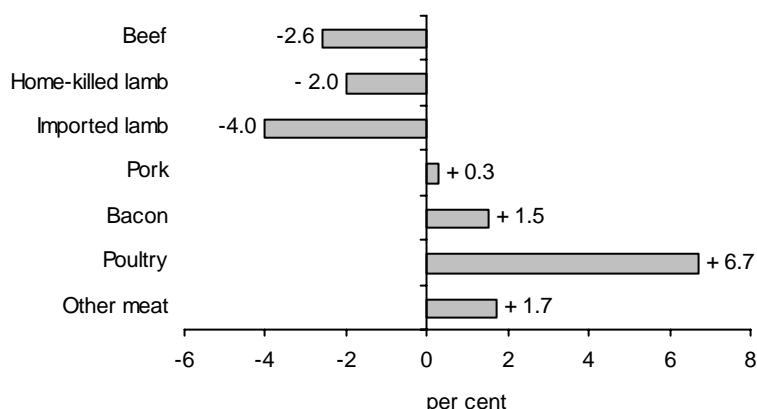
Source: National Statistics, MLC

It means, therefore, that price increases for certain items have a bigger effect on the overall change in the cost of the food basket than others. For example, an average household spends ten times as much on sweets and chocolates as it does on eggs, so the four per cent annual increase in the price of sweets and chocolate in October 2007 had more effect on the total cost of the food basket than the 26 per cent annual rise in egg prices.

It was the 16 per cent increase in fresh milk prices and the 10 per cent increase in vegetable prices (excluding potatoes) that contributed most to the five per cent increase in overall food prices in October.

Each type of meat in the food basket is given a weighting. Beef, poultry and 'other meat' (which includes offal, cooked meats, sausages, pies, pâté and ready meals) have higher weightings than lamb, pork and bacon.

### Change in retail meat prices October 2007/October 2006



Source: National Statistics

In October 2007 the seven per cent annual increase in poultry prices more than offset the three per cent fall in beef prices. The four per cent fall in imported lamb prices compared with 2006 had little effect on the overall meat and bacon price.

## **Global food price hike**

Higher food prices are not unique to the UK. The FAO world food price index rose by nine per cent in 2006. By September 2007 the index was more than a third higher than a year earlier. High international prices for grain are continuing to filter through the supply chain, contributing to a rise in retail prices for bread, pasta, meat and milk.

Tight world grain supplies have been the main force behind the rise in agricultural commodity prices. As well as a rapid decline in grain stocks since the late 1990s, more recent adverse weather conditions have affected the production of wheat and coarse grain in many parts of the world. US, EU, Canadian and Australian combined production fell by 60 million tonnes last season. At the same time as the global reduction in cereal supplies, demand for wheat and coarse grain has remained very strong, particularly in the US.

The combination of high petrol prices and the desire to reduce greenhouse gas emissions is at the forefront of the rapidly expanding production of bio-fuels. This is increasing the demand for feedstocks, most notably sugar, maize, rapeseed, soybean and palm oil, but also for wheat, thereby pushing prices up further.

Freight charges have become a more important factor in agricultural markets than in the past. Increased fuel costs, stretched shipping capacity, port congestion and longer trade routes have pushed up shipping costs.

Exchange rate movements play a critical role in agricultural markets but rarely have they had as much influence on prices as in recent months. The gradual decline in the value of the dollar against most currencies since 2005 has made imports from the US cheaper, thereby increasing demand for products exported from the US.

There is now widespread concern about food price inflation. This is fuelling debate about the future direction of agricultural commodity prices in both importing and exporting countries. However, the fact that the UK is experiencing stronger food inflation than elsewhere in Europe, suggests that it is not simply an environmental phenomenon.

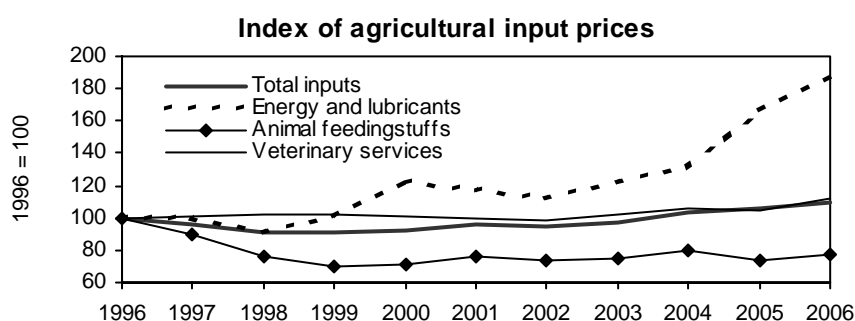
### **Drivers of the recent food price increases**

There are two main reasons for the recent rise in UK food prices. Firstly, grain prices are rising as supply shortages, caused in part by the growth of the biofuels industry and poor harvests, combine with rising demand for high-protein foods from developing countries and in particular from India and China. This is pushing up the feed costs of animal production. These increased costs are being passed onto the retailers and ultimately the consumer. For example, the cost of a pint of milk has reached an all-time high of 33.5p.

Secondly, many basic products are influenced by the cost of oil rather than actual ingredients. Although the average price of sliced bread is a record £1.20 in the supermarkets, wheat makes up only 7p of the production costs. Baking, packaging and distribution costs, all of which are determined by the price of fuel, account for a greater share.

## Input prices of food and meat production

In 2006 the purchase price of all means of agriculture in the UK was 10 per cent higher than in 1996. Input prices fell during the late 1990s, before increasing at the turn of the decade. The largest annual rise occurred in 2004.



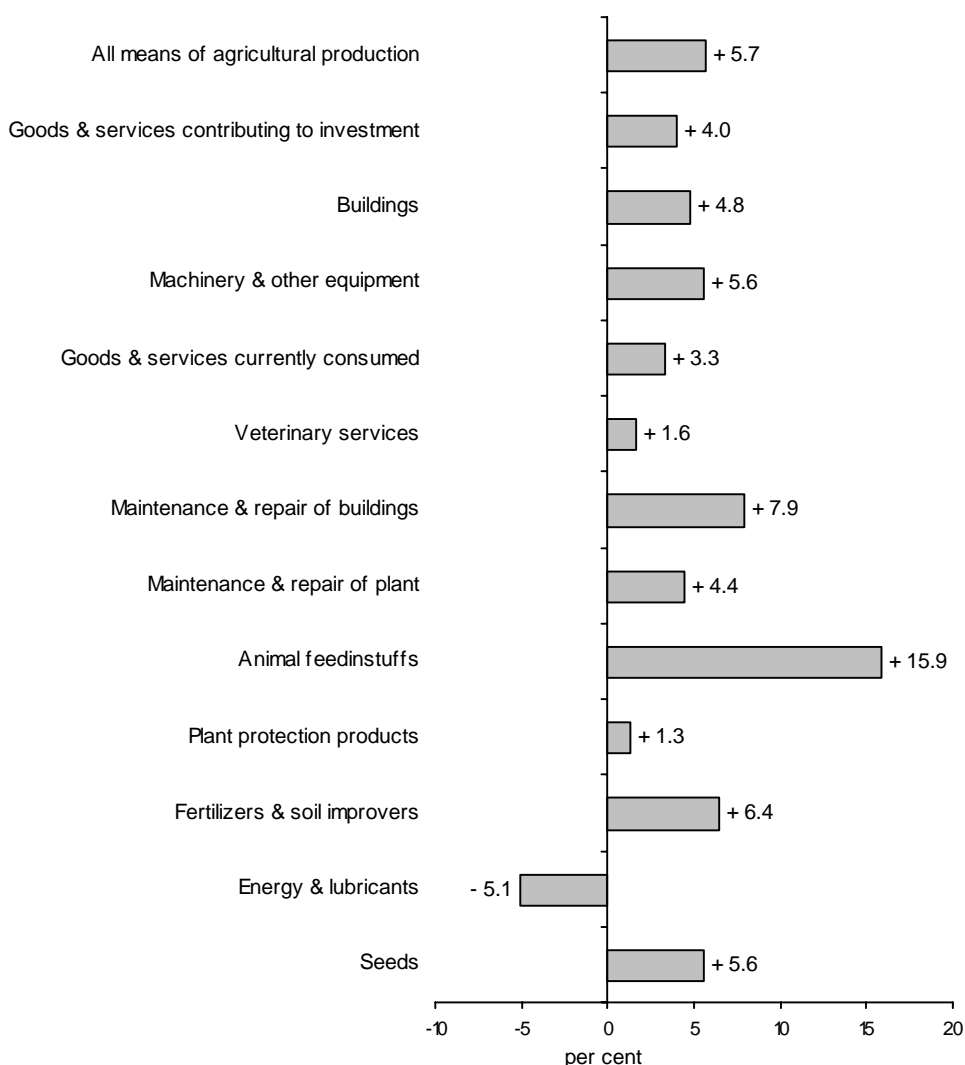
Source: Defra

Feed is the largest single variable cost in animal production. For cattle and sheep, excluding forage, feed accounts for 20 to 30 per cent of total variable costs. For pigs and poultry it is nearer 80 per cent. However, over the 10 years from 1996 to 2006 feed input costs fell by nearly a quarter as world supplies of grain increased. In contrast, energy and lubricant costs have risen nearly every year since 1996 and in 2006 were almost 90 per cent higher than 10 years earlier. Veterinary costs were 12 per cent higher than in 1996.

In January-September 2007 the combined agricultural costs of production were six per cent higher than a year ago. The

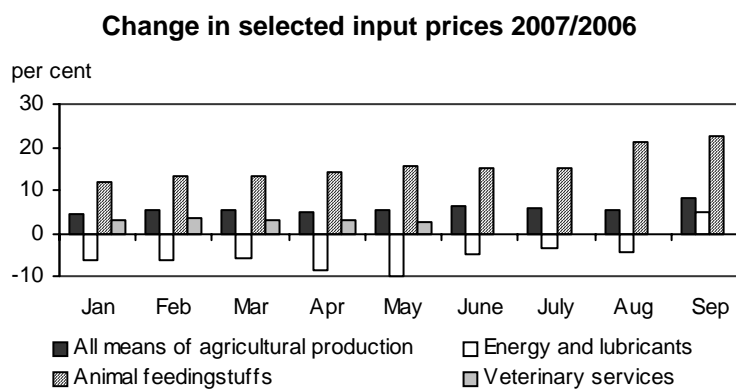
largest increase was in the purchase price of animal feedingstuffs which rose by 16 per cent. Straight feedingstuffs cost 24 per cent more and compound feedingstuffs 10 per cent more.

## Change in agricultural input prices January-September 2007/2006



Source: Defra

Each month this year feed prices have been higher than in 2006. In August and September livestock producers had to pay over 20 per cent more than a year ago for their feed. The next largest increase in cost over the nine-month period was that incurred for the maintenance and repair of buildings. In the four months January to April 2007 farmers were paying around three per cent more for veterinary services than a year ago. Since then the annual increase has diminished.



Source: Defra

### Oil price now having an impact on food costs

The increase in oil prices has only just started to filter through to producers' energy costs. In January – September 2007 energy and lubricant input prices were five per cent less than a year ago. They were lower in all months except for September when they were up five per cent compared with 2006.

### References

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- The Agricultural Market Impact of the Growth in Biofuels – OECD
- High Prices and Volatility in Agricultural Commodities – FAO