

Inflation Handbook: Food Prices — 2023 Disinflation, 2024 Stabilization

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August 17, 2023

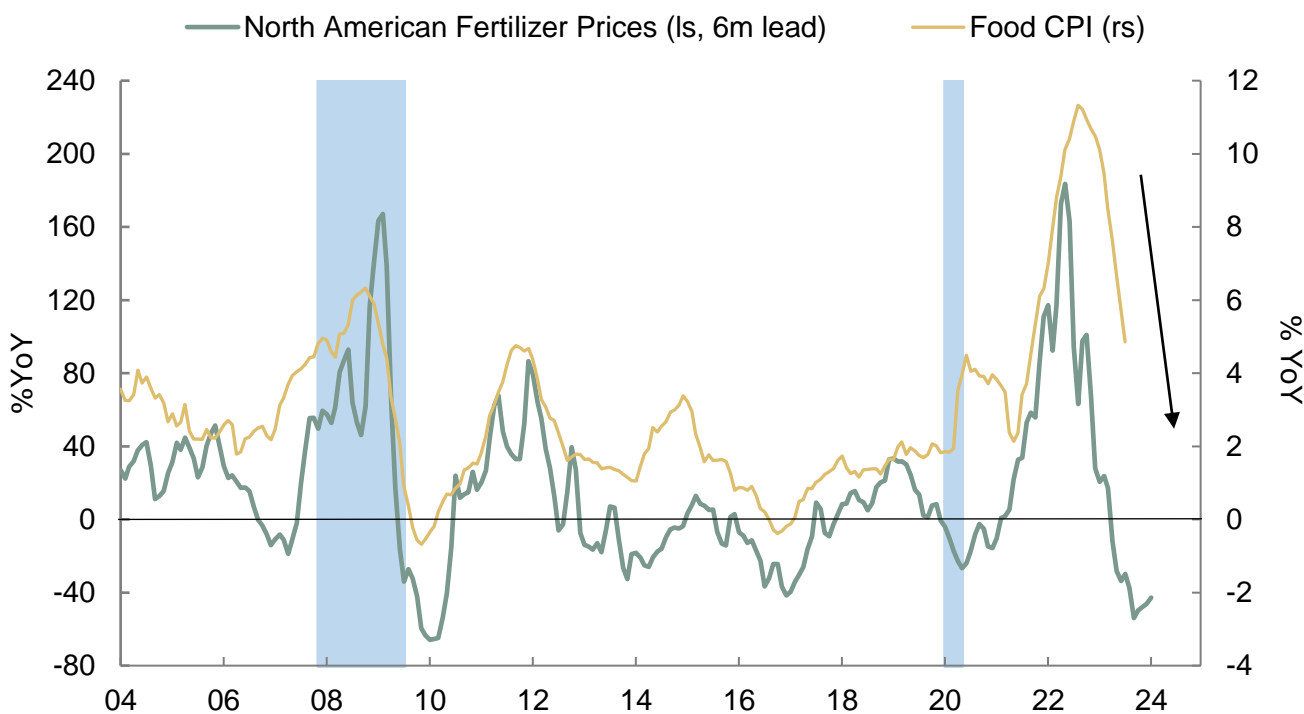
Introduction

Last year, food prices increased 10% in what was the largest annual up-move since 1979. Last summer, we argued that substantial food price disinflation was on the way due to a few dynamics which continue to play out. We discuss these forces here and what this means directionally for our food inflation forecast.

Food prices are important to monitor because they have a sizeable impact on overall inflation (food accounts for over 13% of the consumer price index) and because outsized moves in the cost of necessities directly impact the demand for discretionary items.

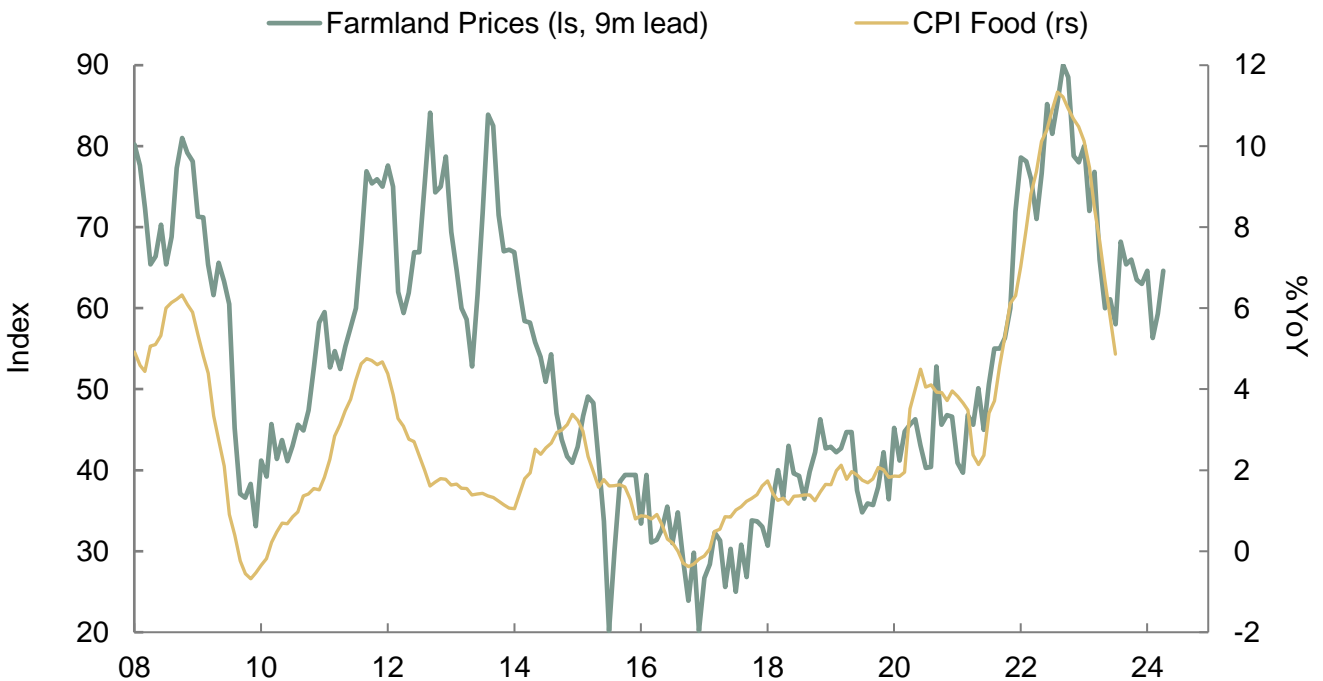
Fertilizer — Disinflationary

The first, and most important factor determining the food price trajectory, is fertilizer — a key input cost in farming. Statistically, where fertilizer goes, food goes six-months later. This can be seen below. As of the end the of July, fertilizer prices are down nearly 43% on a year over year basis. These data suggest that food prices have another six months of disinflation in the pipeline.



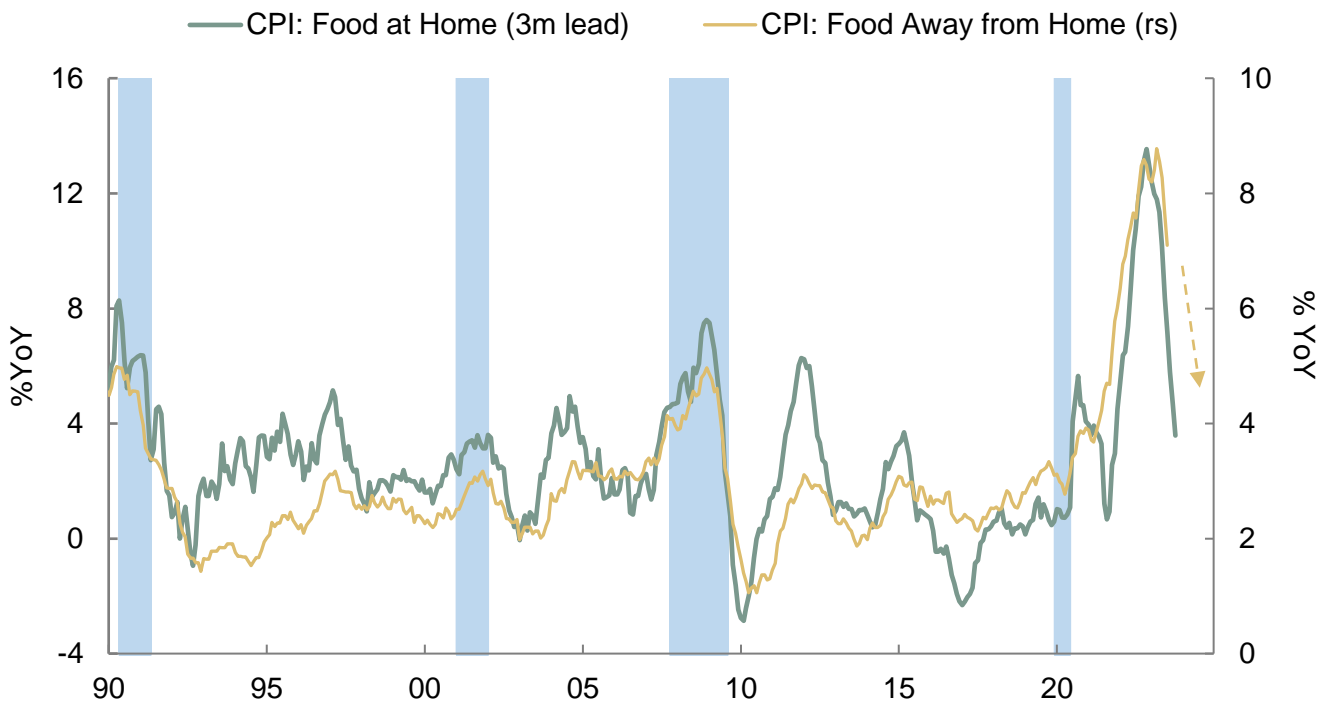
Farmland Prices — No Longer Disinflationary

The next most important factor is the price of farmland, which statistically leads food prices by nine-months. This is shown in the chart below. What is *supportive* of food prices — or at least what is no longer a deflationary force — is that farmland prices have trended mostly flat (albeit with some volatility) in 2023. This factor suggests that prices will be nearing a point of stabilization in the next handful of months.



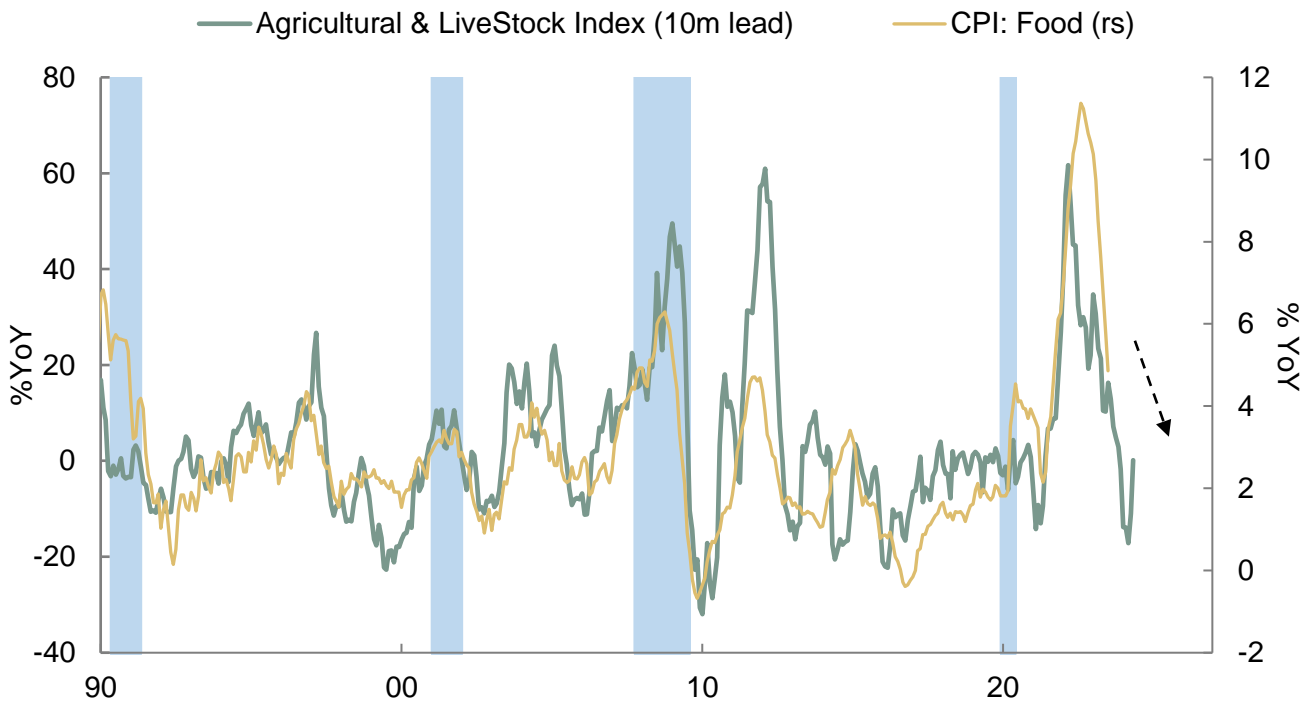
Food Prices at Home — Disinflationary

We also look at a more mechanical dynamic: the tradeoff between food prices from eating at home or food away from home (i.e.: restaurants). The prices of the two are linked but the former leads the latter. If food prices at the grocery store come down (up), restaurant prices come down (up) too. Historically, this process takes three-months to complete. At home food prices have slowed precipitously to 3.6% YoY in July (compare this with 11.4% in January). If the relationship between the two holds, prices for food away from home statistically speaking should fall to 4.6% YoY by October (from 7.1% presently). This move alone would subtract nearly 90 bps from food inflation over the next three months.



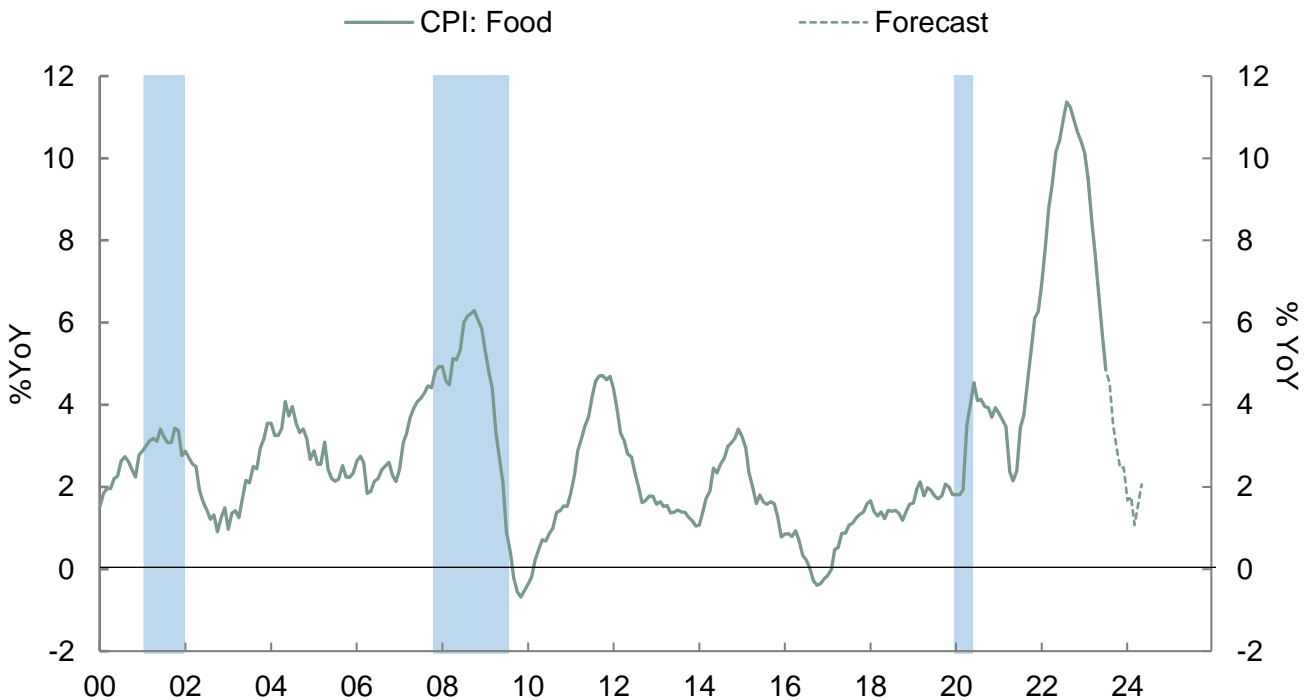
Agriculture and Livestock Prices — Disinflationary...for Now

Where commodities markets trade agricultural and livestock products tends to lead food prices by roughly 9-12 months. This relationship, shown below, implies that overall food inflation as measured by the CPI should decelerate to 1.1% in March 2024 and bottom, before reaccelerating to 2.1% in May 2024. However, this is highly uncertain considering the recent increase in both agricultural and energy-based commodities prices.



Outlook

Amongst the four primary factors that we use to forecast future food prices, three (fertilizer, food at home versus away from home relationship, agricultural commodities) suggest that more disinflation is on the way. The collection of these forces tells us that food prices will decelerate to just 2.5% YoY by yearend 2023 (versus the present 4.9% YoY rate), before further decelerating to 2.1% YoY by May 2024. Such a result would be right back in line with pre-Covid rates of food inflation.



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