

»» Food inflation: a brief intermezzo



No. 131, 12 May 2017

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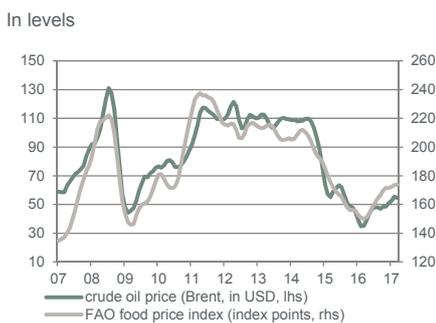
Inflation in Germany has increased noticeably from low levels since last autumn. Food prices were a major driver. Should we be concerned?

Price drivers: politics, weather, oil

At the beginning of the year, we analysed the inflationary trend in Germany in a Focus¹ and mentioned food prices briefly. We now take a closer look at the factors that influence them.

In its 'Commodity Markets Outlook'², the World Bank regularly lists the drivers of world food prices. It mentions **agricultural policy, weather events and energy prices**, as agriculture is a very energy-intensive industry. With respect to agricultural policy, the World Bank currently sees no upward risks that are of relevance to Germany. The same is true of supra-regional weather phenomena, since the El Niño/La Niña cycle ended in early 2017. That leaves energy prices which, for their part, are dominated by the price of crude oil.

Figure 1: Crude oil and international food prices



Sources: Bloomberg, FAO

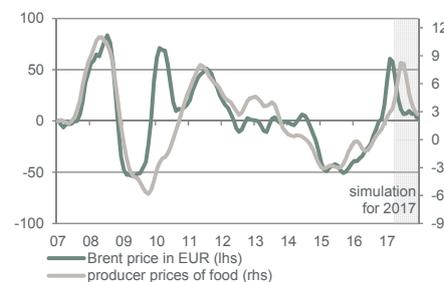
A closer look at crude oil prices

Figure 1 shows that **crude oil prices** indeed correlate closely with **international food prices**.³ Most national food prices, for their part, are heavily

influenced by global markets and therefore display similar patterns. After all, producer prices at national level respond first, followed by consumer prices. A glance at the corresponding German indexes confirms this (Figures 2 and 3).

Figure 2: Crude oil price and German producer prices for food

Annual variations in per cent, 3-m. moving averages



Sources: Federal Statistical Office, KfW Research

With regard to **crude oil prices**, we expect the sideways movement that can be observed since December 2016 to continue over the next quarters. Our estimate is that US shale oil production in particular will cap the price roughly on the current levels. What, then, should be expected for food inflation?

Food inflation is short-lived

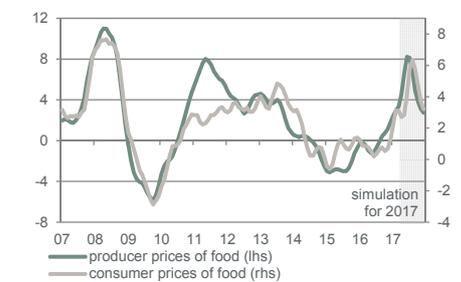
The development of German **producer prices** for food pointed upwards until March; its latest annual variation rate was 3.8%. Crude oil prices, which are higher than last year, can be expected to drive this change further. In our simulation we expect the annual variation rate to peak at 9% in the current quarter (Figure 2).

Shortly thereafter, **consumer prices** should reach their highest annual variation rate this year, at around 7%. But even then, according to our calcu-

lations, total inflation would be merely 1.8% for Germany in 2017 – because food only makes up 10% of the basket of goods and services. As the crude oil price continues to move sideways, food inflation should fall again noticeably later in the year.

Figure 3: German producer and consumer prices of food

Annual variations in per cent, 3-m. moving averages



Sources: Federal Statistical Office, KfW Research

Prices may even rise significantly less

Our assumptions on producer and consumer prices are relatively strong. In particular, food prices for consumers do not always follow those of producers with the same intensity, as shown by the phase between 2010 and 2012 (Figure 3). In fact, in April consumer prices rose by only 1.8%. In other words, food inflation could turn out much lower than we have simulated.

Either way, food inflation is likely to increase markedly in the coming months but will then probably drop again significantly. Consequently, this should not be a concern for monetary policy. Rather these developments are part of the normalisation process the German and the euro-area economy are currently undergoing – after a prolonged period in which price increases for producers and consumers of food remained unusually subdued. ■

¹ Cf. Wanke, S. (2017), Inflation in Germany rises only briefly above two per cent, KfW Research, Focus on Economics No. 160.

² Cf. World Bank, Commodity Markets Outlook, April 2017, Washington D.C., p. 9–12.

³ The FAO Food Price index is a monthly index calculated by the Food and Agriculture Organisation of the United Nations. It measures the development of international prices of a basket of food commodities.