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NOTE FOR THE FILE

Subject: Update on recent price developments in EU-27 agriculture and food retail

1. FARM GATE PRICES, AGRICULTURAL MARKET PRICES AND INCOME DEVELOPMENTS – *STATUS QUO* AND OUTLOOK

1.1. Farm gate and agricultural market prices

After two decades of price decline in real terms, agricultural commodity prices started to rise at the end of 2006. The surge in prices is mainly attributed both to structural and short-term factors. While the former type of driving forces is generally made up by the gradual rise in global food demand, the emergence of new market outlets (biofuel – mainly in the US), a slow down in EU yield productivity and an overall incapacity of major exporting countries to keep pace with demand growth, the restructuring of the EU farm sector towards greater competitiveness and the slow adjustment capacity inherent to agricultural markets, the latter factors mainly emanate from adverse climatic conditions, the growth in activity of investment funds and trade restricting behaviour of many exporting countries.

It is interesting to notice that in 2007 compared with 2006, agricultural commodity prices in the EU have developed rather consistently both at agricultural producer and wholesale respectively first-stage-processing level¹. Prices for crops, poultry, eggs and milk showed substantial increases in 2007 compared to 2006, while prices for cattle and pigs decreased.

Lower cattle prices resulted from a higher domestic production and an increased import volume, the latter can mainly be attributed to Brazilian beef re-entering the EU market after disease (Food and Mouth Disease) related market disruptions. Pig prices in 2007 fell below their exceptionally high 2006 levels (but remained in the range of longer-term average prices), with a substantial domestic overproduction preventing a visible transmission of significantly higher feed costs into livestock prices.

¹ Annual averages of agricultural producer prices can be obtained from Eurostat, while agricultural market price information is i.a. available through the DG AGRI data warehouse Agriview.

Table 1: Year-on-year (2007/06) change in EU agricultural market prices

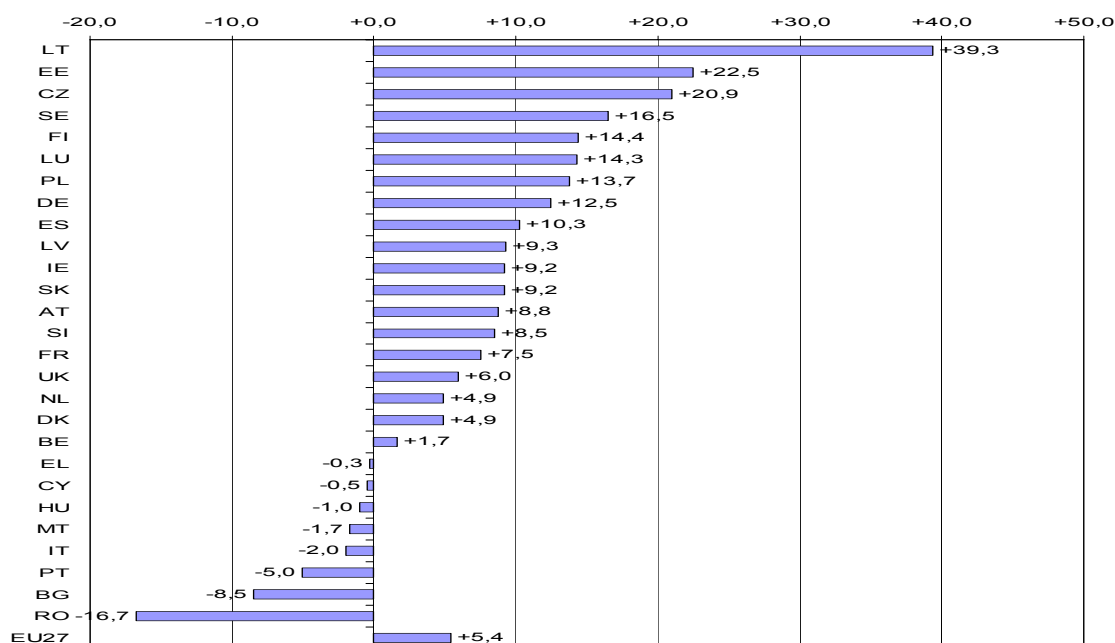
soft wheat	50%
durum wheat	60%
feed barley	49%
maize	40%
rape seed	34%
male adult cattle	-5%
pigs	-7%
broilers	17%
cows' milk	24%
eggs	16%

Source: DG AGRI – Agriview.

1.2. Developments in agricultural income

As regards developments in agricultural income in 2007 compared to 2006, latest statistics reveal a positive year-on-year change for most of the EU Member States. Negative or less favourable figures for some countries mainly result from a relatively low importance of the crop sector in their national agriculture and/or a high importance of the negatively affected pig/intensive cattle fattening sectors through higher feed costs. Furthermore, losses in output volumes due to adverse climatic conditions significantly affected agricultural revenues and income in these countries (this was particularly the case for Bulgaria and Romania).

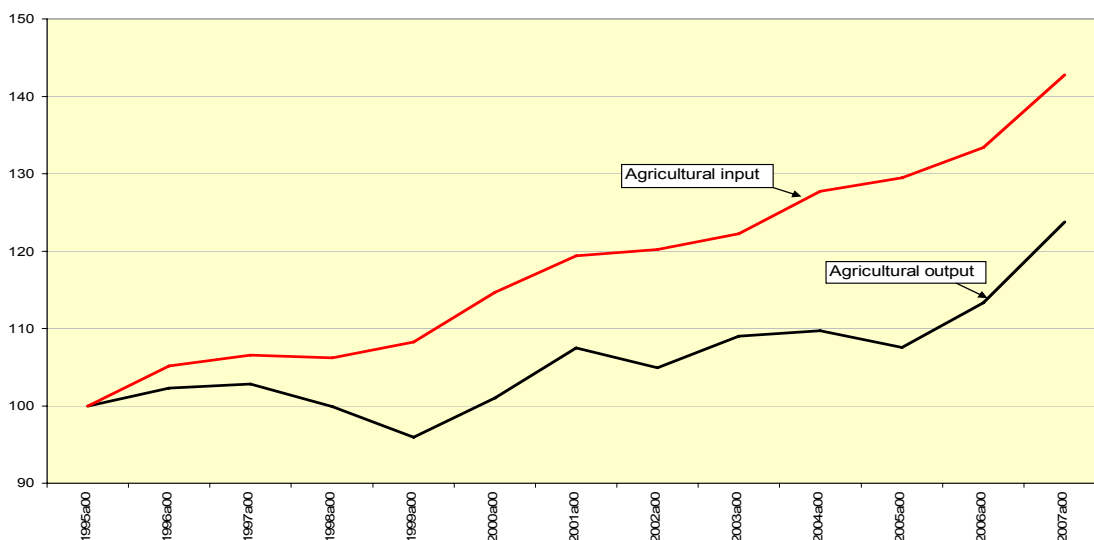
Graph 1: Year-on-year (2007/06) change in real agricultural factor income per annual work unit (%) by Member State



Source: Eurostat.

The longer-term trend of deteriorating terms-of-trade in the EU agricultural sector improved only slightly in 2007 as the recent increase in agricultural output prices took place alongside a steep rise in agricultural input costs in 2007 compared to 2006.

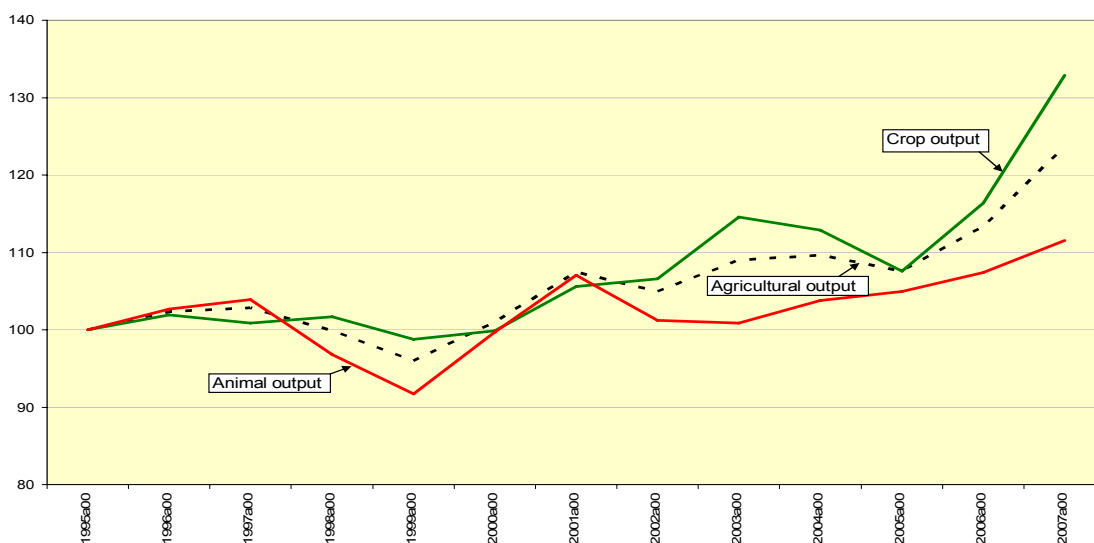
Graph 2: Development in EU-27 agricultural input and output price indices (1995=100)



Source: Eurostat.

As regards agricultural product price indices, animal output prices tend to lack behind crop output prices. Given the 'feed-interlinkage' between the animal and crop sectors, it can hence be expected that animal output prices will shift further upwards in the future.

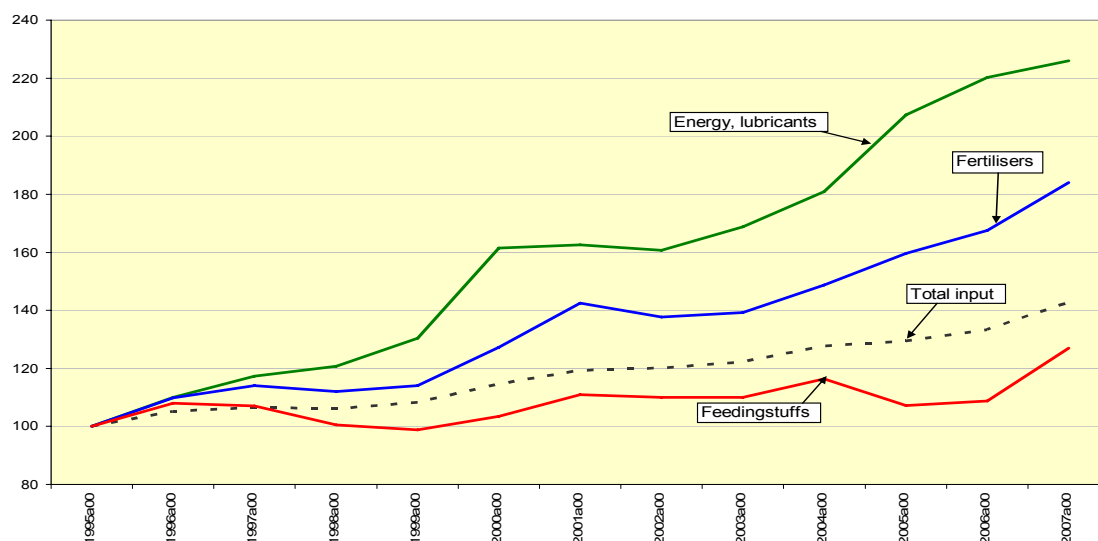
Graph 3: Agricultural output price development in the EU-27 (1995=100)



Source: Eurostat.

As far as agricultural input prices are concerned, historically, the increase in feedingstuff prices used to be rather limited as compared to the observed price rises for energy/lubricants and fertilisers. Notwithstandingly, in 2007 compared to 2006, feedingstuffs showed the biggest price increases among all agricultural inputs, driven by the price rises recorded in the grain and oilseed sectors (but feedingstuff prices still developed below overall input price inflation over a long-term perspective).

Graph 4: Agricultural input price development in the EU-27 (1995=100)



Source: Eurostat.

1.3. Price outlook

Regarding future perspectives for agricultural commodity prices, many structural factors are expected to sustain market prices over the medium term. However, it is forecast that prices would not remain at the exceptional levels recently observed, mainly due to predictable producer responses to high prices (additional supply potential can be mobilised globally and particularly in the developed world) and policy adjustments such as the removal of mandatory set-aside for the 2008/09 marketing campaign, the suspension of the import duties for most cereals until the end of June 2008 and the additional 2% dairy quota increase in the EU in 2008.

Pork prices are expected to cyclically rise and, finally, to explicitly reflect higher feed costs in the coming months, a development which is already observed in the poultry and egg sectors. However, the current situation of an extremely unfavourable cost/revenue relation in pig production is forecast to result in an accelerated structural change including further sectoral/regional concentration and specialisation. In order to ease the difficult situation for pig producers, the Commission opened a private storage aid scheme² and extended the range of products eligible for export refunds.

EU and Oceania dairy prices have been continuously converging over recent years, with interregional prices nowadays reaching rather comparable levels. However, after the peaks observed in summer 2007, dairy prices have meanwhile come back to 'more normal' levels (and milk producer prices may be expected to follow soon). In general and over the medium term, dairy prices are forecast to remain on a higher plateau, albeit at a lower level than seen in 2007.

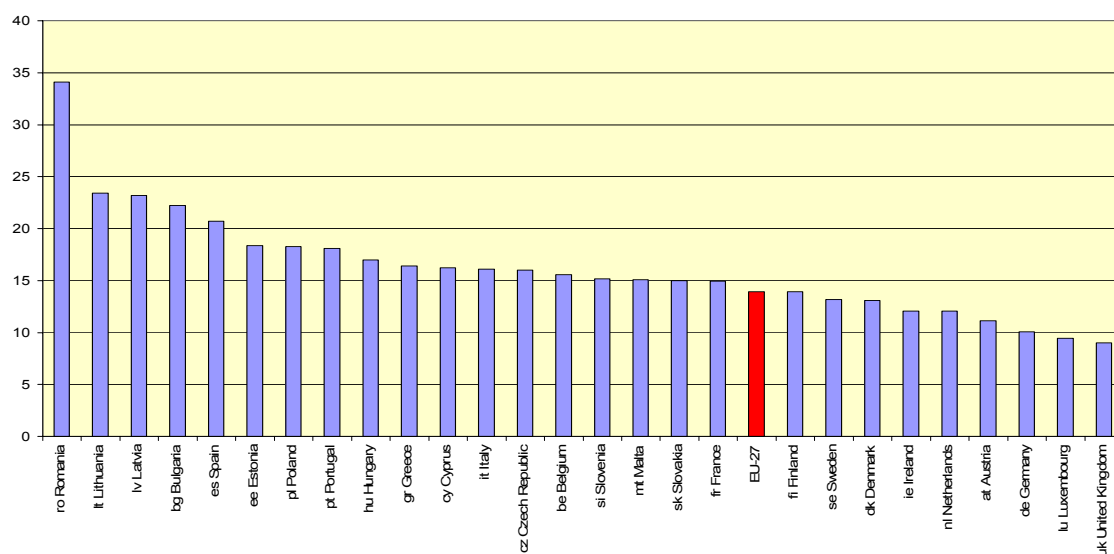
² The scheme was open from 29 October 2007 until 4 December 2007. During this period, a quantity of around 100.000 t of pig meat has been contracted, mainly for a storage period of 5 months (later on, the maximum storage period was prolonged to 8 months).

2. IMPACT OF HIGHER AGRICULTURAL PRICES ON CONSUMERS

The impact of higher agricultural prices on consumers should be more limited, given the low share of agricultural raw product value in final product value (approximately 25% on average) and the low share of household food expenditure in total household expenditure (14% in 2007, new methodology).

The share of food expenditure in total household expenditure varies considerably among Member States (reflecting differing income/welfare levels). Within Member States, the respective share varies between different household types (household types differentiated by household income, household composition and household location).

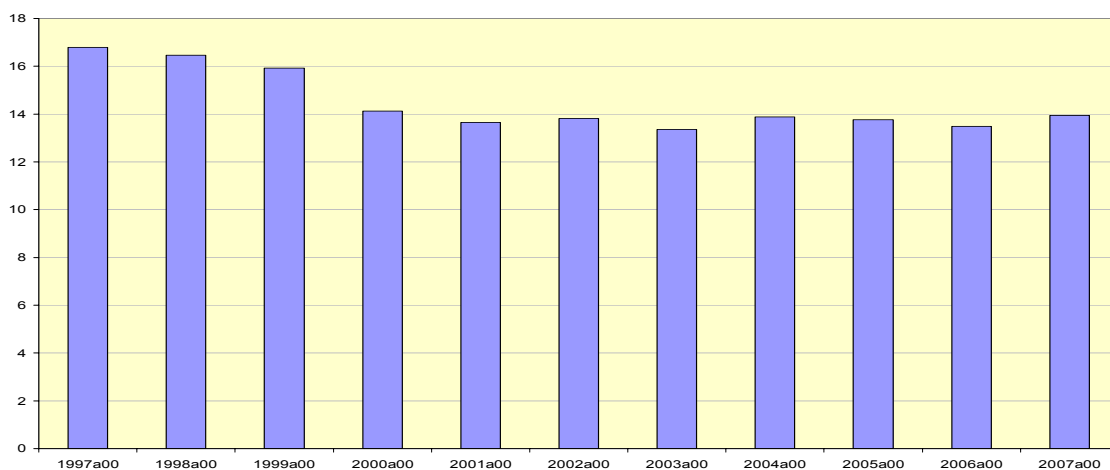
Graph 5: Share of food expenditure in total household expenditure by EU Member State in 2007 (%)



Source: Eurostat.

It should be noted that the share of food expenditure in total household expenditure has recently started to (slightly) increase again (breaking the falling trend recorded in past decades).

Graph 6: Year-on-year change in the share of food expenditure in total household expenditure in the EU-27 (%)

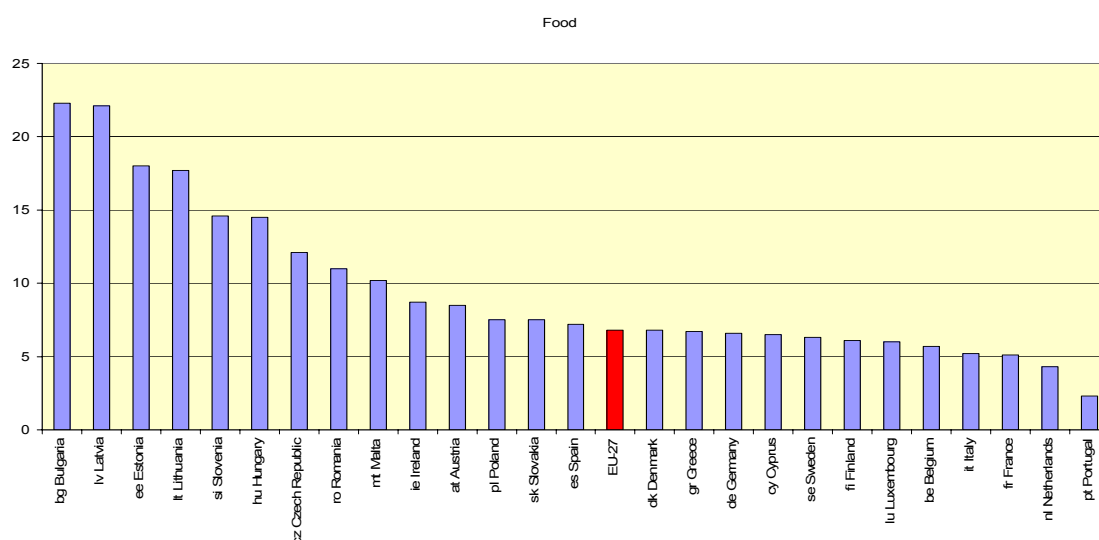


Source: Eurostat.

Furthermore regarding the impact of higher agricultural prices on consumers, it should be mentioned that low-income households would be more affected. This can be explained by the higher share of food expenditure in total household expenditure recorded for low-income households and by the fact that low-income households simply have less flexibility to adjust their expenditure in reaction to higher food prices.

Following the extreme agricultural commodity price developments recently seen, food consumer prices have already responded. This resulted in higher food price inflation than overall inflation. Put into an historical context, recent food price increases at retail level had record character for several product groups. It should be pointed out that food price inflation remarkably differed among Member States, reflecting varying shares of agricultural raw material values in overall food production costs, the food consumption structure and the degree of processing in each Member State, the effect of enlargement (price convergence in the single market), the competitive structure of the food supply chain in each Member State (including concentration and market segmentation) as well as marketing strategies of the food industry and retail sector.

Graph 7: Year-on-year (February 2008/February 2007) food price inflation by EU Member State (%)



Source: Eurostat.

Calculating the theoretical impact of higher agricultural prices on consumer prices, on consumer expenditure for food and on the overall purchasing power/standard of living of an average EU household, it becomes clear that agricultural commodity price increases observed in February 2008 compared to February 2007 should have resulted in 3% higher prices for "bread and cereals based products", 8% higher prices for "meat" (assuming full/perfect transmission of higher feed costs into livestock prices), "oils and fats", and 12% higher prices for "milk, cheese, and eggs". The overall food price increase should have reached around 5% (i.e. in line with the first estimates presented in September 2007), other food consumption items being equal.

Compared with latest (up to February 2008) data on consumer prices (Harmonised Index of Consumer Prices from Eurostat), it appears that total food price inflation as measured by the HICP already (slightly) exceeds the "theoretically-derived" price increase. With the exception of meat (where the difference can i.a. be explained by the assumption of

full feed cost transmission), real price increases are higher for all sub-categories as compared to the theoretical calculation.

Consequently, it appears that only parts of the observed price increases at retail level can be attributed to agricultural commodity price increases (with the "residual element" resulting from developments in other cost components making up the final product value at retail level, such as labour and energy costs, and/or higher margins over the food supply-chain).

Consumer price increases seem to be particularly high for milk, cheese and eggs. Here it seems that recent price decreases seen on dairy commodity markets have not yet been transmitted to consumers. The same could hold true for oils and fats (at least for the 'butter component' of this product group (butter prices have remarkably decreased at wholesale level in recent months); however, vegetable oil prices are on the rise)). As regards bread and cereals, recent consumer price increases appear also to be higher than what could have been expected from the impact of higher cereal prices.

Table 2: Impact of higher agricultural prices on retail prices

Impact of higher agricultural prices on retail prices...

		...in theory		...in reality	
<i>Feb08/Feb07</i>		<i>estimated change in</i>		<i>observed change in</i>	
<i>agricultural price development</i>		<i>consumer prices Feb08/Feb07</i>		<i>HICP Feb08/Feb07</i>	
Wheat	84%	Bread and cereals	3%	Bread and cereals	10%
Maize	28%				
Poultry	9%	Meat*	8%	Meat	4%
Pigs	3%				
Cattle	2%				
Butter	21%	Oils and fats	8%	Oils and fats	12%
Rapeseed oil	63%				
Milk	30%	Milk, cheese, eggs	12%	Milk, cheese, eggs	15%
Cheese	35%				
Eggs	17%				
		Aggregate	5%	Aggregate	7%

*Taking into account the indirect impact of feed costs on livestock prices.

Source: Own calculation on the basis of data from DG AGRI – Agriview, Eurostat and other sources.

It should be noted that high food prices in the EU in February 2008, as measured by the price change as compared with February 2007, are present in almost the whole basket of food products in the HICP. Annual rates have reached the highest levels since 1996 (beginning of HICP-series) for six food classes: "bread and cereals", "milk cheese and eggs", "oils and fats", "sugar jam and confectionary" and "food products n.e.c". Annual rates for meat prices have risen to 3.7% but are far from the high levels that were reached in 2001 (however, as already mentioned, meat price increases can be expected for the future).

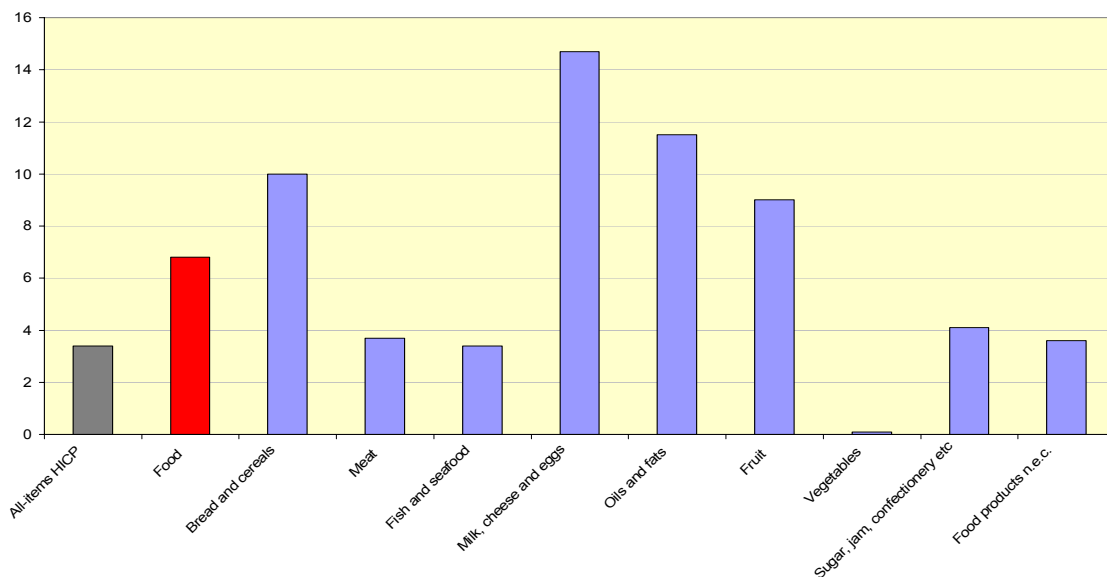
The impact of higher food expenditure on the purchasing power/standard of living of the average EU consumer is found to be more limited given the relatively low share of food expenditure in total household expenditure (theoretically, the purchasing power of the average EU household would only decrease by around 0.7%). However, it should be pointed out again that low-income households are particularly affected.

Given the increase in the retail prices of food products higher than what could have been expected from higher commodity products for most of the food product categories as shown in Table 2, the (against the long-year trend) increasing share of food expenditure

in total household expenditure, the meat price increases still to come and the generally increasing rate of overall consumer price inflation, a close monitoring of the developments in food prices appears necessary.

In this respect, further analysis of the competitive structure of the food supply chain, including concentration and market segmentation of the retail and distribution sectors would allow to better assess the situation.

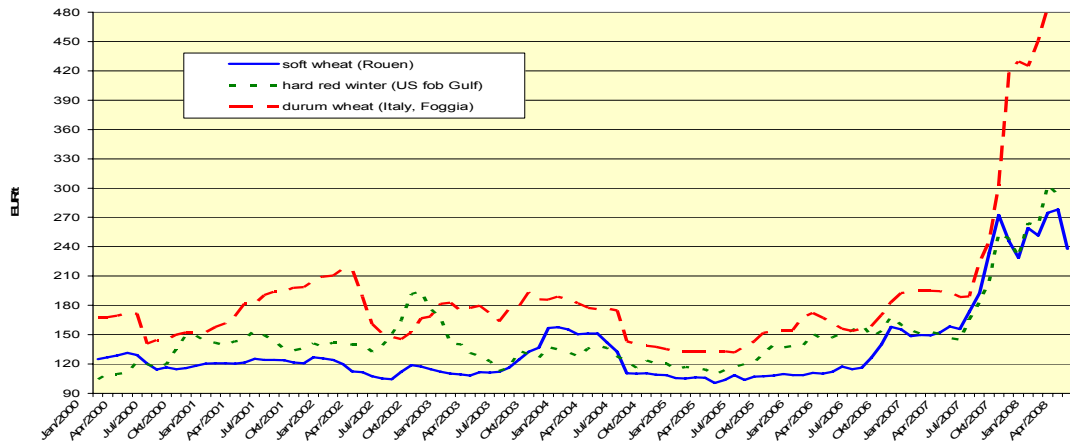
Graph 8: Year-on-year (February 2008/February 2007) overall and food price inflation in the EU-27 (%)



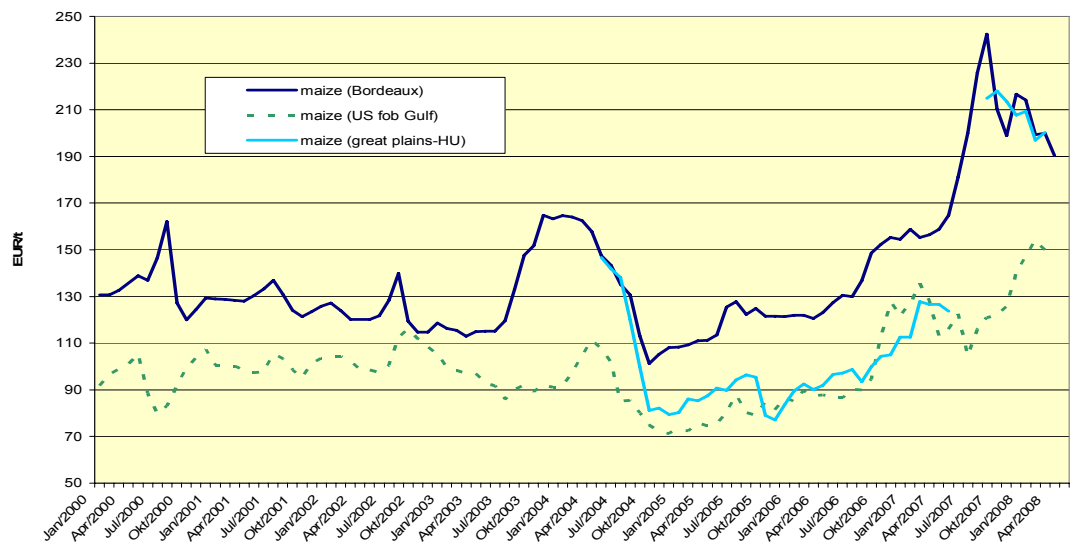
Source: Eurostat.

Annex: Graphs on agricultural market and consumer price developments (Source: DG AGRI services, DG AGRI - Agriview, Eurostat).

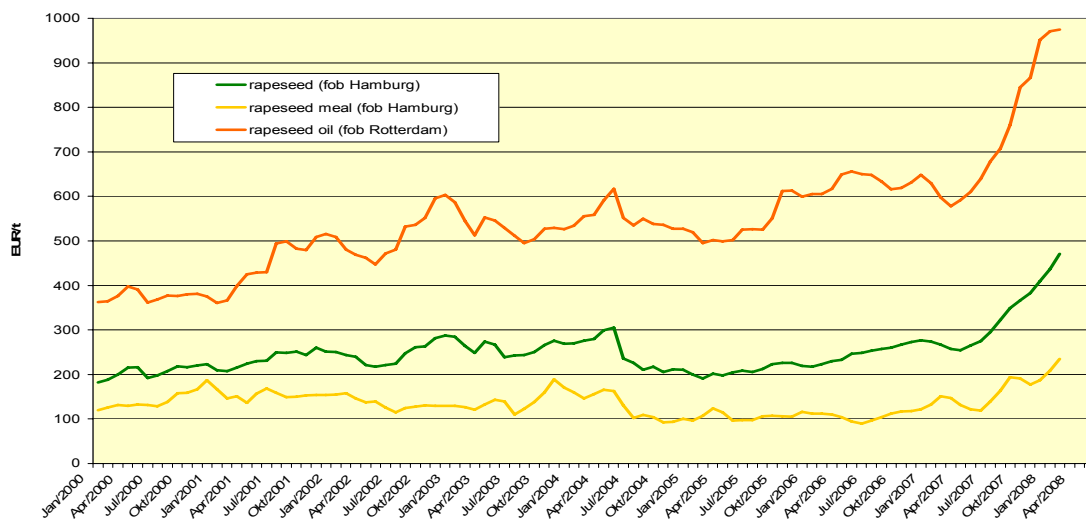
Graph A1: EU and international wheat market prices (EUR/t)



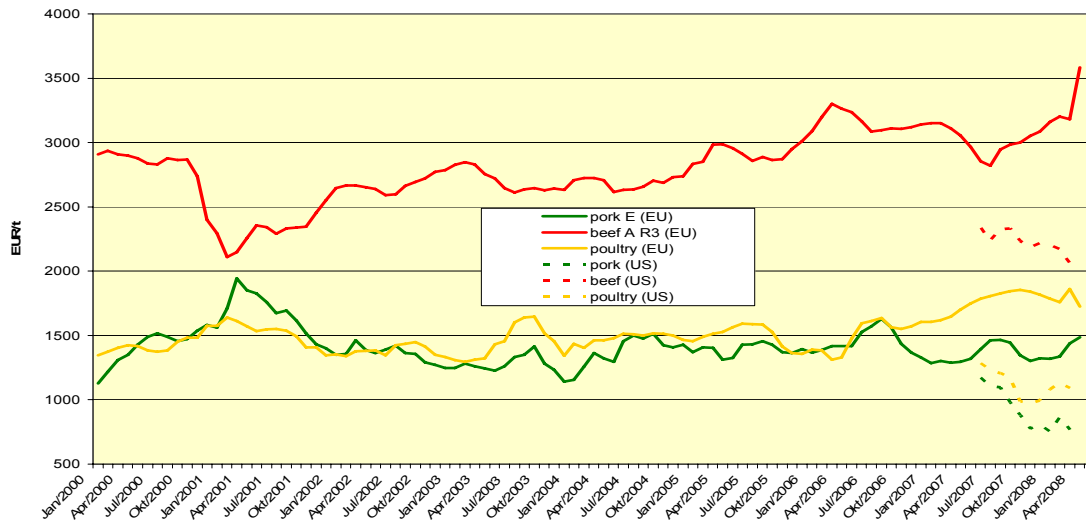
Graph A2: EU and international maize market prices (EUR/t)



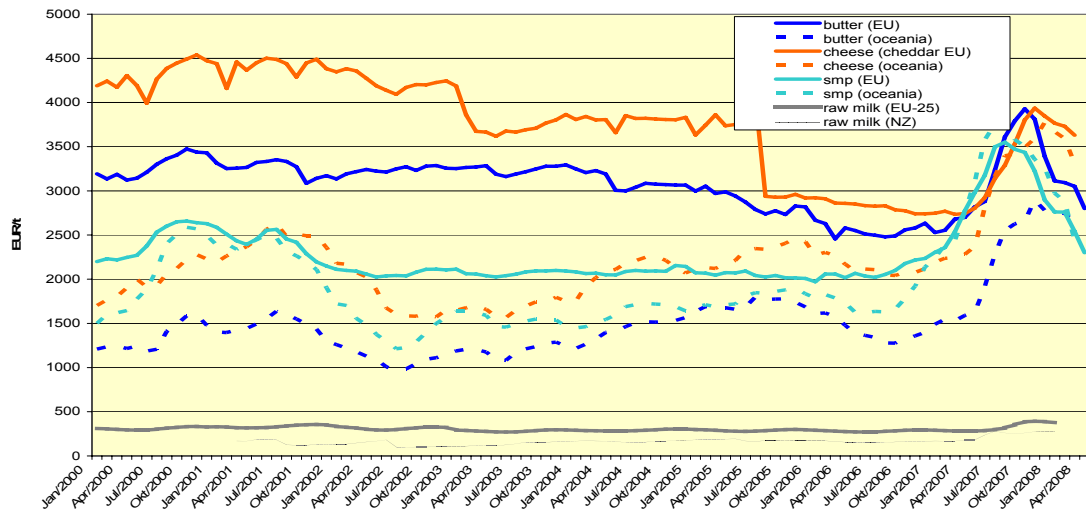
Graph A3: EU and international market prices for the rape seed complex (EUR/t)



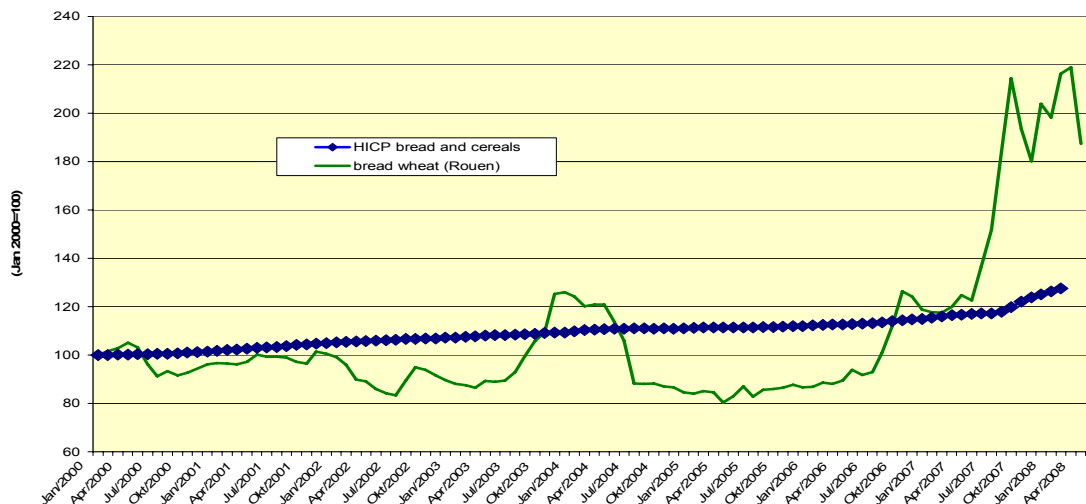
Graph A4: EU and international meat market prices (EUR/t)



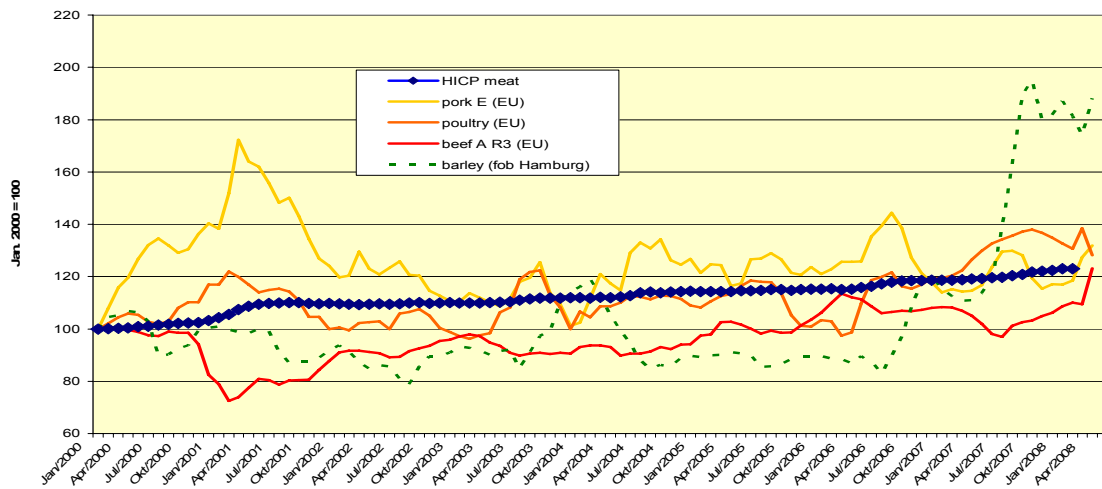
Graph A5: EU and international dairy market prices (EUR/t)



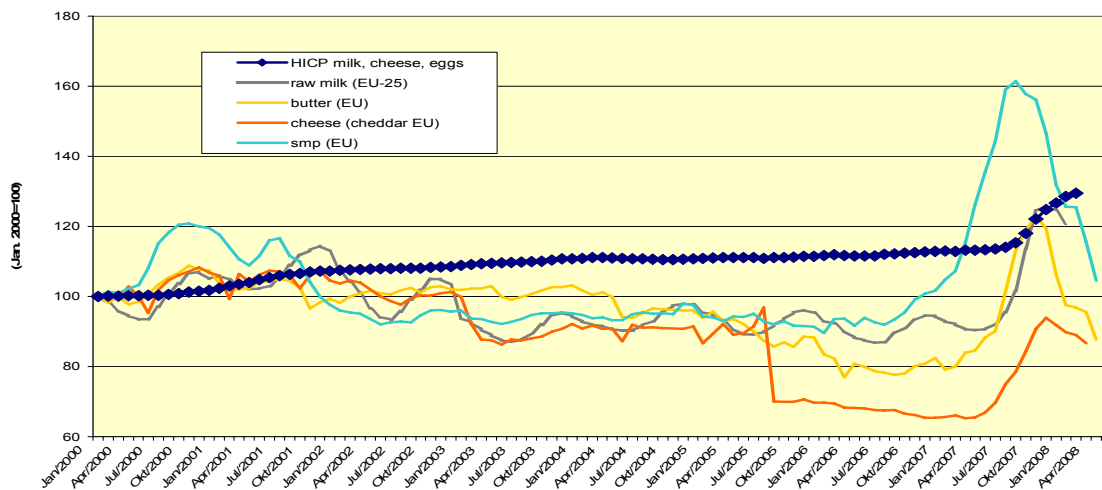
Graph A6: EU agricultural market and consumer price indices for bread wheat and "bread and cereals" food products (Jan 2000=100)



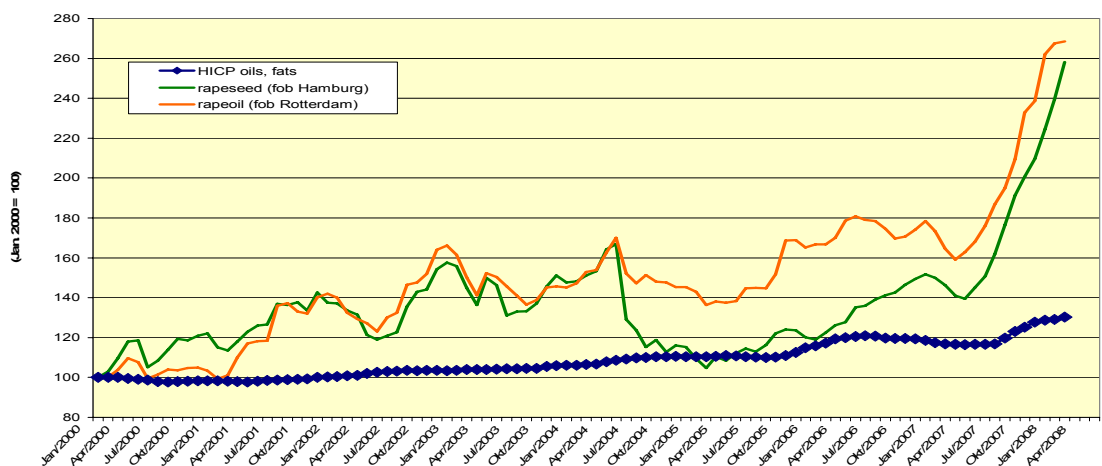
Graph A7: EU agricultural market and consumer price indices for meat (Jan 2000=100)



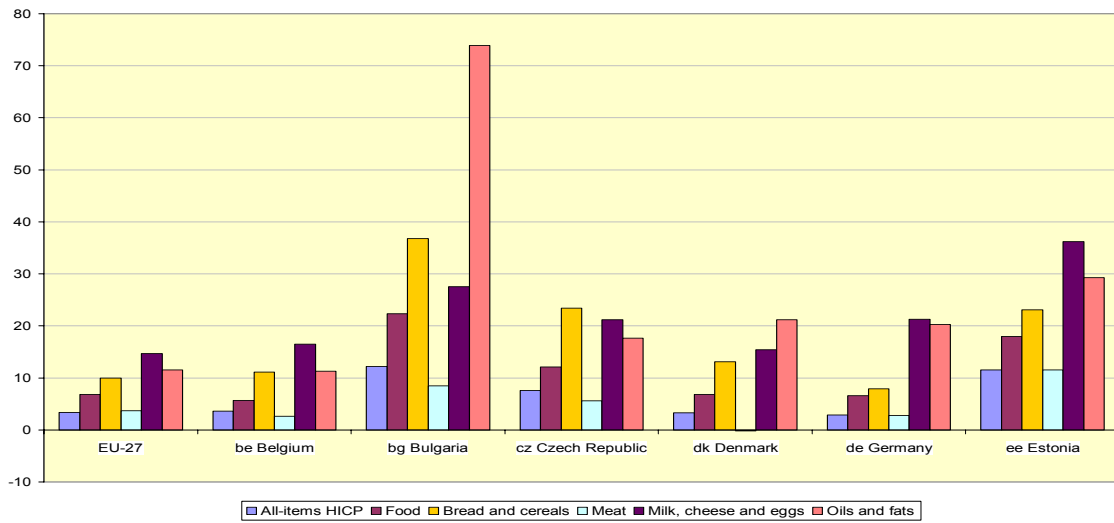
Graph A8: EU agricultural market and consumer price indices for milk and dairy products (Jan 2000=100)



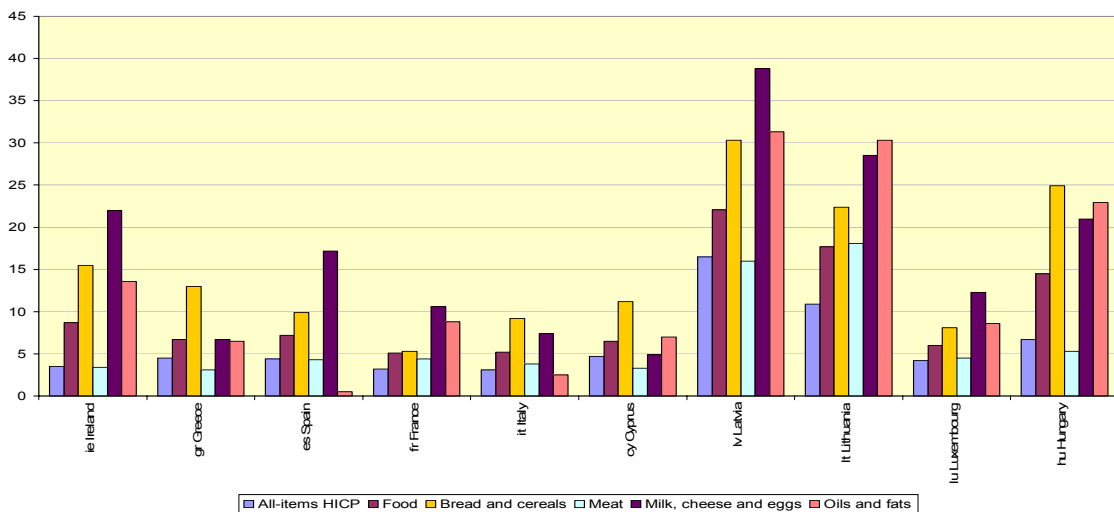
Graph A9: EU agricultural market and consumer price indices for rapeseed, -meal and -oil (Jan 2000=100)



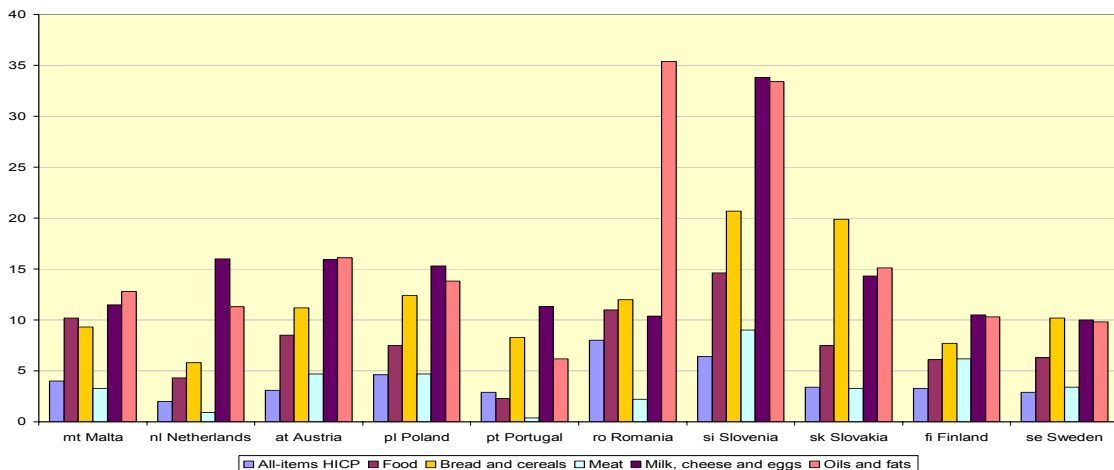
Graph A10: Year-on-year (Feb08/Feb07) consumer price developments by EU Member State (%)



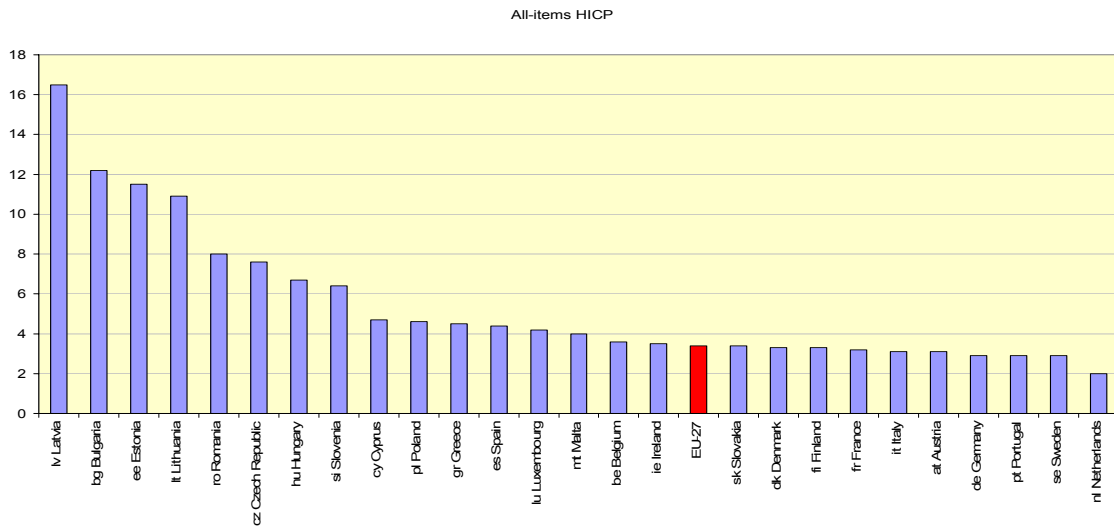
Graph A11: Year-on-year (Feb08/Feb07) consumer price developments by EU Member State (%)



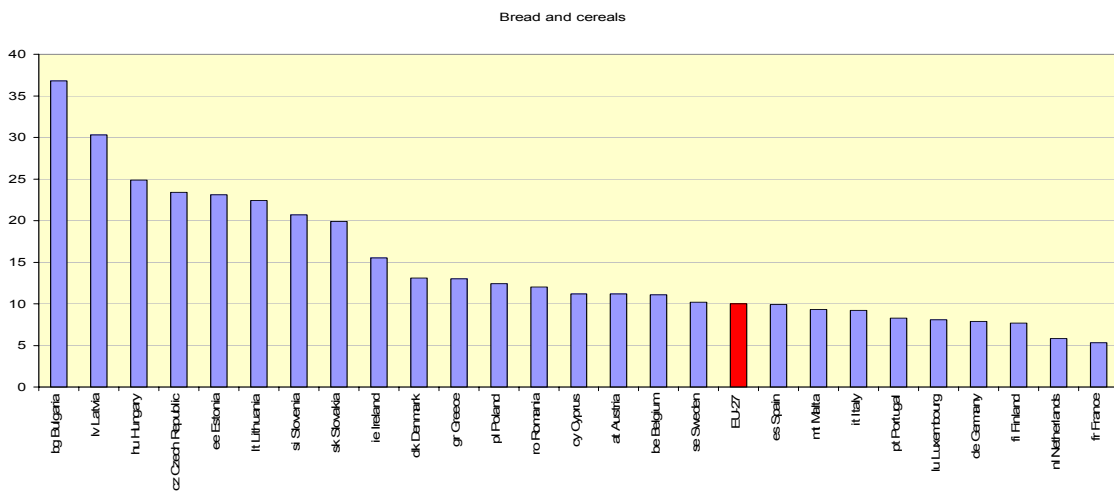
Graph A12: Year-on-year (Feb08/Feb07) consumer price developments by EU Member State (%)



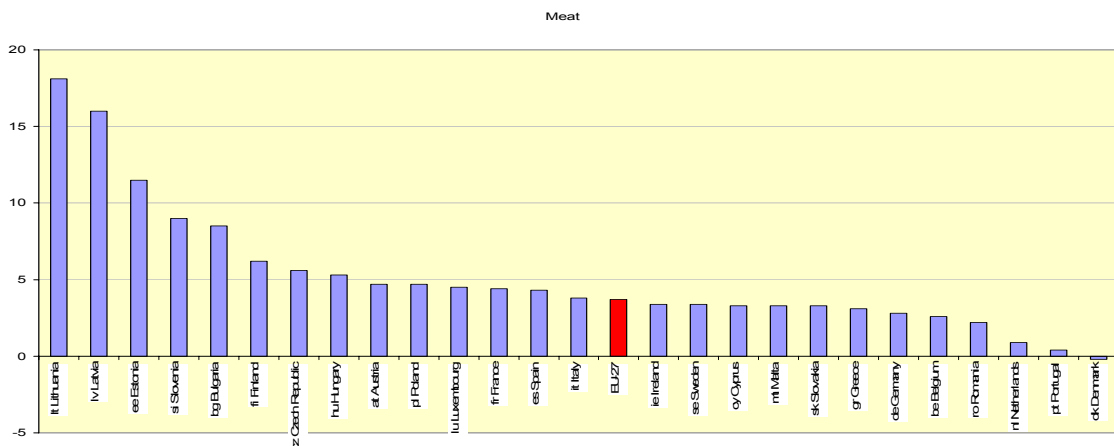
Graph A13: Year-on-year (Feb08/Feb07) rate of overall consumer price inflation by EU Member State (%)



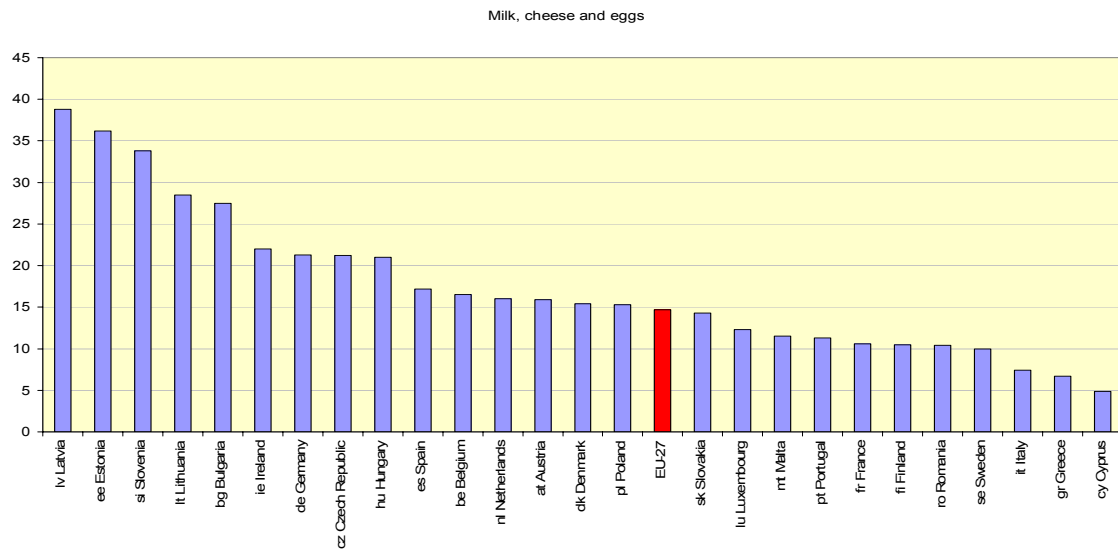
Graph A14: Year-on-year (Feb08/Feb07) rate of "bread and cereals based products" consumer price inflation by EU Member State (%)



Graph A15: Year-on-year (Feb08/Feb07) rate of "meat" consumer price inflation by EU Member State (%)



Graph A16: Year-on-year (Feb08/Feb07) rate of "milk, cheese, and eggs" consumer price inflation by EU Member State (%)



Graph A17: Year-on-year (Feb08/Feb07) rate of "oils and fats" consumer price inflation by EU Member State (%)

