Get used to the 'new normal' of high-priced food

ASIAN DEVELOPMENT BANK REPORT

IWAN J AZIS BANGKOK POST/ 8 NOV 2011

Catastrophic flooding and crop losses in Thailand, the world's leading rice exporter, are raising concerns that another food crisis may be in the offing.

More disquieting is the possibility that the world may have already entered a new era where persistently high food prices are the "new normal".

At a time when policy-makers are grappling with a host of thorny economic issues, the possibility may be unwelcome, but must not be ignored.

Although volatility in commodity markets is nothing new, there are worrying signs that food price fluctuations are now taking place within a much higher bandwith than ever before. Even when prices dip they remain high by historic standards, and when prices rise it's enough to put a serious dent in families' budgets.

For Asia's poor, who already spend 60% of their household budget on food, even the smallest fluctuation in food prices forces unenviable choices on where best to devote their scant resources.

More money for food means less for healthcare, education or other important expenditures. It also means that those striving to escape poverty are less likely to do so, while millions more risk falling below the US$1.25 (38 baht) a day poverty line.

important tradable asset class, just like stocks, bonds, currencies, or real estate. As a result, movement in one major asset — say, real estate prices in the United States — can drive food prices in other parts of the world to levels well above what real supply and demand might dictate. The current super-easy money policy in industrial countries may have also driven the financialisation of commodities.

And then of course there's the weakness of the US dollar, in which most food commodities are denominated, as well as high oil prices, which raise costs at almost every step of the food supply chain, from fertiliser and animal feed, to fuel for bringing food from the farm to kitchen table.

With a "new normal" of persistently high and volatile food prices here to stay, what are policy-makers to do?

There are no easy solutions, but when faced with bouts of soaring food prices, governments must be both pragmatic and flexible.

Tightening monetary policy — like raising interest rates — is a standard tool to combat inflation and cool economic overheating. It is a fairly ineffective tool if the inflationary pressure is supply-side, however, and relatively blunt if price movements are volatile. Rate hikes take months to show results, and if overblown can tighten the economic leash until it chokes growth, especially for small and medium businesses.

Inflation targeting is also of questionable value if the public does not view the measures as credible. Consumers need to know what to expect. With food price inflation on the rise, social programmes that target the most

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The Asian Development Bank estimates that a 10% rise in domestic food prices in developing Asia threatens to push an additional 64 million people into poverty.

With food price inflation in many emerging Asian economies averaging 11% in the first half of 2011 alone, the growing numbers of families facing the scourge of dire poverty is staggering.

Much of the sharp increase in the region's food prices is due to production shortfalls caused by extreme weather events — such as droughts and floods — and subsequent export bans by some food producing countries. Growing appetites for grains, oil, seeds, sugar and livestock in emerging economies like China and India are exerting further upward pressure on supply.

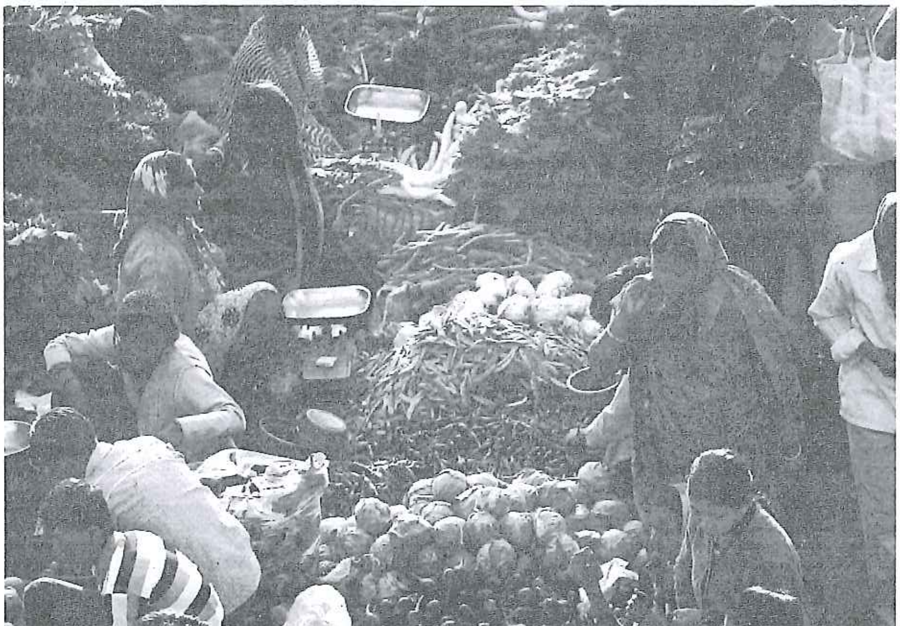
There has also been a growing trend over the past decade to "financialise" commodities, turning food into an

vulnerable members of society from the effects of higher commodity prices can be used where budgets allow. This measure is less costly for the economy as a whole, compared to tightening monetary policy.

There are other levers policy-makers can pull, including a broad range of supply-side policies that can reduce bottlenecks in commodity-based industries, improving access to global markets and increasing productivity.

The further reduction of trade barriers between countries — to counter local food shortages through imports from surplus producers — should be pursued through regional cooperation and other forums.

Global markets where commodity-based financial derivatives are traded and priced should be regulated and closely supervised to avoid excessive volatility, or the formation of price bubbles.



Record-high food prices are moving to the top of the agenda for many Asian policy-makers as higher inflation in 2011 poses a major threat to the region's strong revival from the global financial crisis.

They can also be used effectively as a hedging tool to manage risk.

In large countries overall food supply may not be a problem, yet there are still serious problems in some sub-national regions.

In such instances, improved distribution channels to ensure a more reliable supply of commodities to remote and isolated areas can play a critical role.

Taken together, it is clear that a globalised approach is needed to effectively address food price inflation. Countries normally address their own needs as they see best, but the demands of rapid economic growth and development increasingly cross borders.

While acting nationally, policy-makers will need to think globally and coordinate regionally. Only then can we be assured that enough resources will be available to keep growing appetites satisfied at reasonable costs.

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