



Pathfinder Economic Flash

Possible Food Price Crisis: Let's be Prepared

The worst drought in the US in at least five decades has resulted in the loss of one-sixth of the expected corn crop.. The US Department of Agriculture (USDA) has estimated that corn farmers have been compelled to abandon fields greater in area than Belgium and Luxembourg combined, following the hottest July ever recorded in US history. In addition, the soya bean harvest this year is expected to be the worst in five years.

Corn is mainly used to feed animals and produce ethanol as a fuel substitute. Soya bean is used for vegetable oil production as well as for animal feed. The USDA has forecast that prices for the two crops would break records. The meat industry will be hardest hit. The supply disruption and high prices will result in lower domestic consumption in the US and less exports. The global markets for cereals are also being adversely affected by the drop in Russian wheat production due to the heat and dry soils. The US and Russia are the two largest grain exporters in the world.

The inclement and volatile weather in other areas of the world, including a weak monsoon in India and drought in parts of China, has resulted in spikes in the prices of other food crops as well, including rice and sugar. Prices of key food commodities have already recorded double digit increases in global markets.

The surge in prices has revived memories of the food crisis in 2007/08 when high food prices triggered riots in more than 30 countries worldwide. At this point, the Food and Agricultural Organisation (FAO) is contending that the situation is not as severe as five years ago. It has pointed out that global rice and wheat stocks remain high. (It should be noted, however, that the FAO has a strong incentive to calm market sentiment at this point to contain speculative activity.) The true picture will not emerge till later in the year when there is greater visibility regarding the output of the Northern Hemisphere harvest.

It is important that policy-makers monitor developments closely to take proactive measures, including fine-tuning of macroeconomic policies, to contain any adverse impact of rising food prices in global markets on both domestic supplies and the trade deficit.

Food prices are likely to become more volatile, with progressively higher spikes due to: (1) higher demand from an increasing global population and rising incomes in countries like China and India; and (2) more erratic weather patterns attributable to the effects of climate change. Hence high priority should be attached to domestic agricultural development to insulate the local food prices, as much as possible, from the vagaries of global markets. In doing so, it is important to recognise that this would only be effective if the productivity of domestic agriculture is high. Inefficient production behind tariff protection will only impose high prices on the population

Sri Lanka is directly exposed to global supply disruptions (including export bans) and price trends in wheat and sugar. There could also be an indirect impact through higher oil prices arising from reduced ethanol production, particularly in the US. (The rising food prices have revived the calls for the reduction/abolition of the high subsidies provided for ethanol production. The UN has recently urged the United States not to use corn for ethanol production taking into consideration the impending crisis). The achievement of self-sufficiency in rice,

particularly after the opening up of the North and East, has reduced the country's vulnerability to the vagaries of global markets. However, it would be prudent to continue to monitor carefully the impact of the recent drought to ascertain overall supply prospects in the light of global supply (availability) and price developments.

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