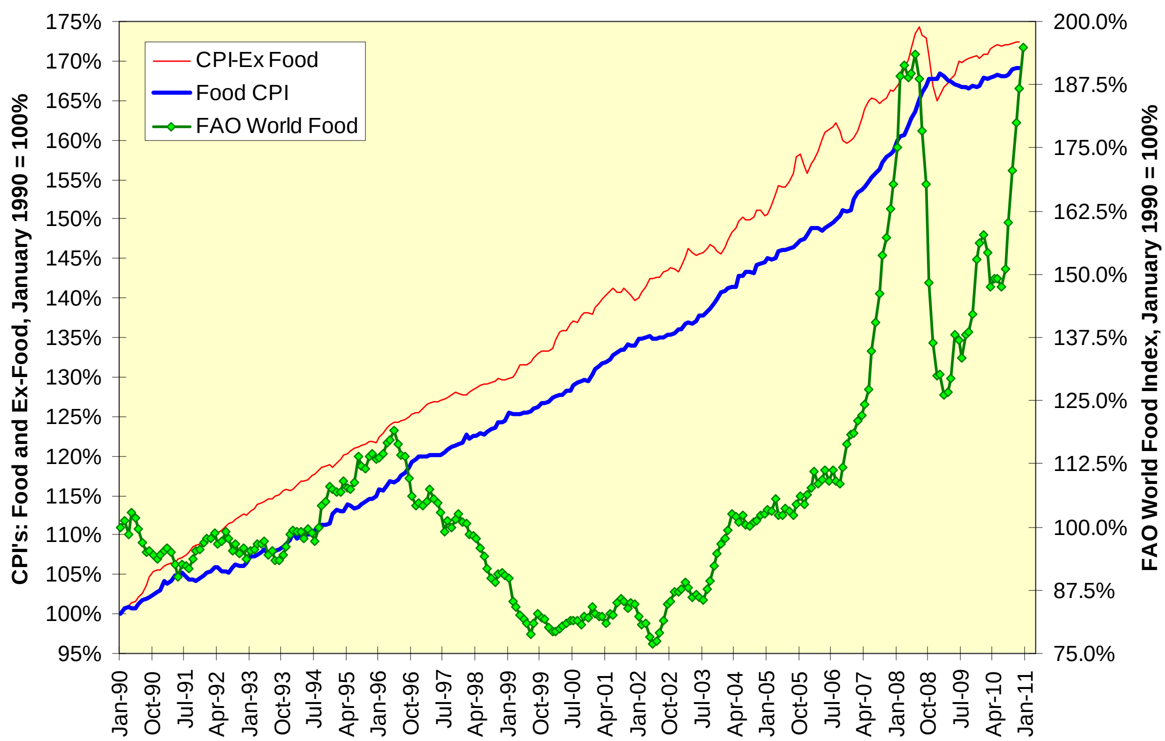
Food Inflation Is A Core Issue

The United Nations' Food & Agriculture Organization always has enjoyed some measure of status as one of the few international organizations with a real track record of accomplishment as opposed to pointless and high-falutin' jaw-flapping. When they announced last week their 55-commodity index of world food prices had reached a nominal high, taking out the June 2008 reading associated with food riots in numerous locales, I took notice. Man may not live by bread alone, but just try living for long without it.

On the surface, the FAO index does not look like it drives the U.S. Food CPI directly; most of the price of the food you buy is related more to processing, packaging, transportation and marketing costs than to raw materials costs. Please note how the FAO index spent much of the 1996-2002 period declining while the U.S. Food CPI chugged higher. Conversely, the jump in the FAO index in 2007-2008 appears to have caused only a minor acceleration in the rate of the Food CPI.

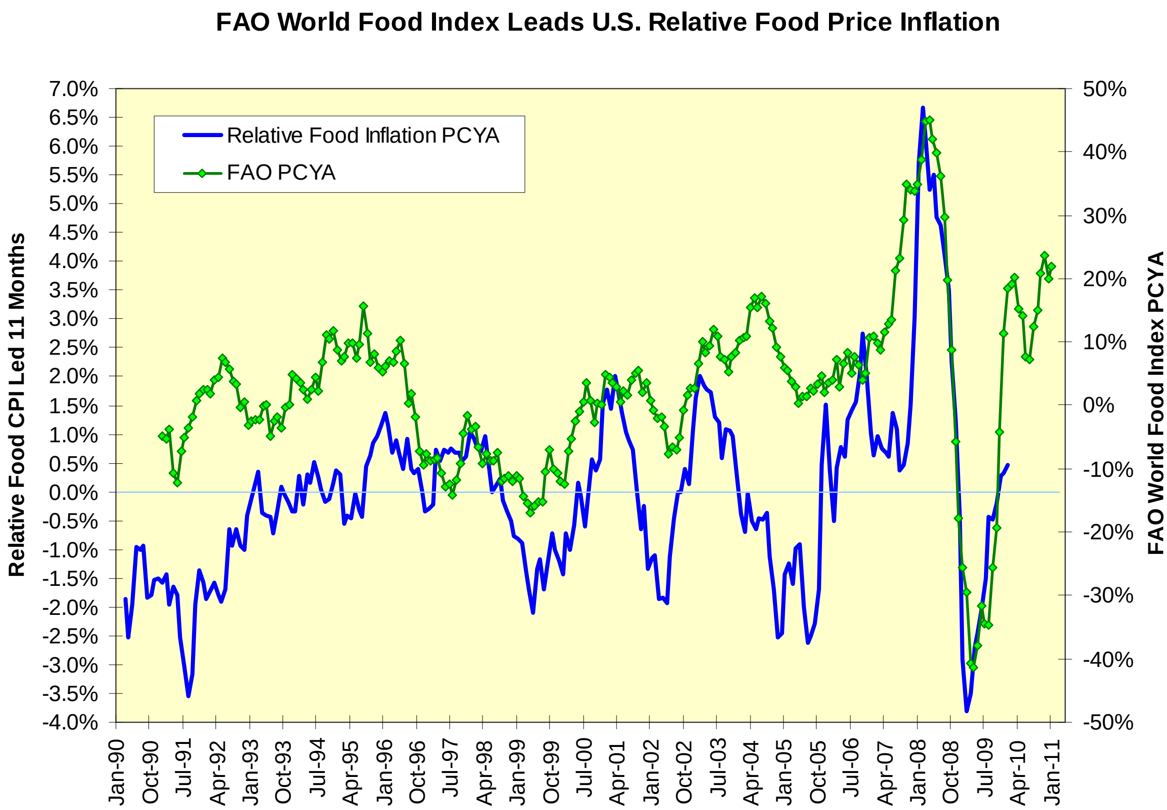
FAO World Food Index And U.S. CPI Measures



Now let's rearrange the data to get at the real, um, core of the issue, and that is the inane classification of price indices into core and non-core components. While it may be true food and energy prices are volatile, that would be like excluding small tech stocks from market indices because, hey, they are too volatile.

Let's look at it another way: If the price of cattle going to the slaughterhouse rise (commodities are not pretty) the price of leather shoes gets measured in the core CPI while the price of beef products are considered non-core and the stocks of any publicly traded companies along the way that might be linked to the price of cattle are not included in any measure of inflation at all as they are assets and not prices. See the difference? Remember, financial assets can be turned back into cash at a later date and therefore represent future capacity to consume.

First, let's take a look at relative year-over-year change of the Food CPI to the CPI Ex-Food and map it against the year-over-year change in the FAO index. Now the issue emerges into full view: The changes in the FAO index lead the relative rate of food to non-food CPI by eleven months. Therefore, we should expect 2011 to be a year of high relative food price inflation; it is (groan) baked in the cake.



As everyone has to eat and as we persist in the idiocy of feeding close to 40% of our corn crop to yeast to make low-grade motor fuel, we are setting ourselves up for a period, such as 1973, when every trip to the grocery store produced its own brand of sticker shock. Those who were around at the time may recall this sense of prices being out of control helped turn popular opinion against Richard Nixon at the time Watergate was moving into full flower.

I am waiting – and I do not think I will have to wait for long – for some too-clever-by-half government economist to tell the public food prices are not an issue because they are not core and the real danger is deflation so we had best print up for few hundred billion dollars more to buy Treasury bonds. It would be funny if it were not so tragic.