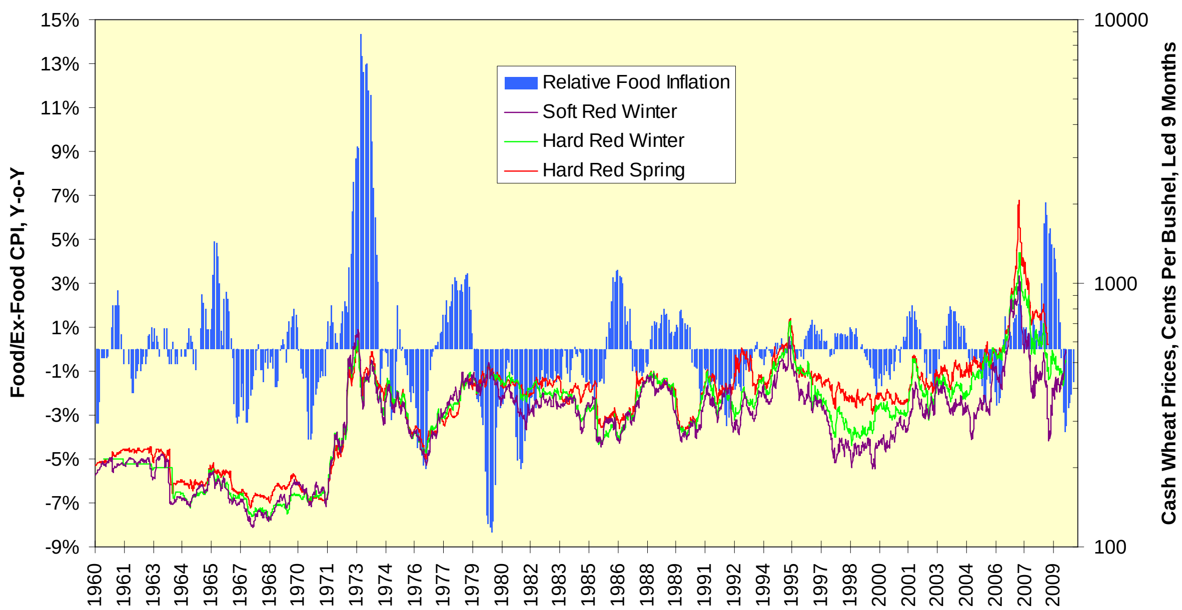
Wheat Not A Worry Yet

Our good friends at the Bureau of Labor Statistics generate all manner of sub-indices for consumer inflation. Some of these are esoteric or are becoming, such as the difference between interstate and intrastate phone calls in an era where communications costs are losing their time and distance dimensions. Others are for discontinuous expenses, such as auto maintenance (Question: When was the last time you were surprised by how little an auto repair cost?). And while the entire distinction between headline and "core," or CPI ex-food and energy, seems strange to consumers who eat and use energy, these categories have their uses for analysts.

Let's take two of these indices, the CPI for food and the CPI for all products ex-food and map their relative year-over-year changes all the way back to the Eisenhower administration. The largest feature on this chart is the huge spike in relative food costs from the early 1970s; this was the time of "The Great Grain Robbery" when Russian buyers moved in en masse and often under the cover of shell companies to replace their own failed harvest. Some posited a deal between them and the Nixon administration involving the Vietnam War, but that was then and this is now.

Wheat Prices And Relative Food Price Inflation Since 1960



How much have wheat prices affected relative food price inflation over the years, and what are the implications of the present jump in wheat prices associated with a drought in Eastern Europe and the former Soviet Union (FSU)? If we map the cash market prices for three major grades of wheat, the soft red winter wheat trade on the Chicago Board of Trade, the hard red winter wheat trade on the Kansas City Board of Trade and the hard red spring wheat traded on the Minneapolis Grain Exchange, we find the connections to be rather tenuous.

There is about a nine-month lead-time between cash wheat prices and relative year-over-year changes in food versus ex-food inflation. That places any impact near the Southern Hemisphere's wheat harvest in early 2011. As most U.S. flour mills, food processors and bakeries have fixed or capped their price commitments, the present jump in wheat futures, about 30% from the 2010 lows reached in early June, should not have an immediate impact either on the operating margins of these firms or on relative food price inflation.

Farmers traditionally favor higher inflation as they are net debtors, leveraged to the prices of food and farmland and tend to regard a weaker dollar as an export-enhancement tool. Moreover, decades of federal agricultural policies have provided price supports to farmers whenever prices fall, and those very same farmers and their political patrons always find a way to capture that money even when prices rise. It will interesting indeed to see whether farmers and politicians from farm states start focusing on relative food price inflation and whether they can convince others higher food prices are somehow in the national interest. Agriculture is and always has been one of America's most productive and one of its most politically favored sectors, and if policies swing in this direction, farm equipment and fertilizer firms should benefit.