

Market Commentary

NZFUNDS

FOOD PRICES TO RISE AGAIN

FEBRUARY 2010

A pickup in the price of soft commodities on the futures market is indicating that the price of food could rise again.

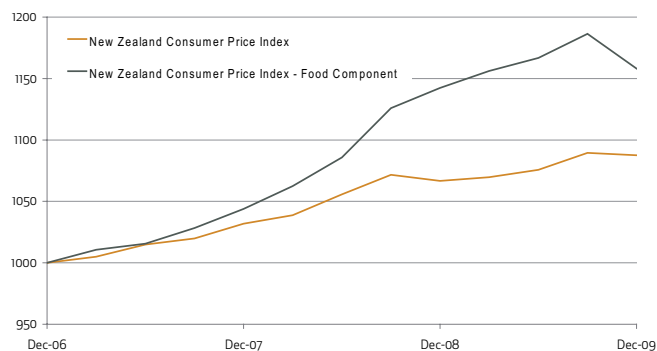
New Zealand recently experienced a quarter of deflation but the trend is unlikely to continue, according to NZ Funds Management's Principal and Senior Portfolio Manager, Daniel Frost. "Soft commodities future prices declined dramatically a few years ago when measured in New Zealand dollars, and are starting to show some signs of life. If the relationship holds and this recovery continues, food prices will begin to rise, putting upward pressure on inflation," Frost says.

Statistics New Zealand recently released the New Zealand Consumer Price Index for the December quarter. The overall index indicated that prices declined slightly over the quarter dropping 0.2%, reducing the annual increase to 2% over 2009. The accompanying chart shows the growth in the New Zealand Consumer Price Index and the food component.

Economists tend to use futures prices on soft commodities as a leading indicator for food prices, as soft commodities (commodities that are grown rather than mined) are either used directly or as an input in processed foods. There is a lag in the impact of futures prices on soft commodities for a number of reasons - these include hedging by food producers (as this locks in old pricing for a period of time) and a reluctance to change prices (producers risk losing market share).

The quarter of deflation was driven by a slump in food prices, wrong-footing a number of economic forecasters. This trend is unlikely to continue as leading indicators suggest the escalation in food prices will once again resume.

NEW ZEALAND FOOD PRICE ANNUAL INFLATION VERSUS SOFT COMMODITY PRICES



Source: Bloomberg.

The chart above shows that the growth in food prices has outpaced the general price level by a significant margin over the last three years. Food prices have grown at 5% per annum while general inflation ran at 2.8% per annum. This escalation has been a major contributor to consumer price inflation in New Zealand. The chart also shows that food prices dropped in the most recent quarter by 2.4%. This decline can almost entirely explain the drop in Consumer Price Index over the quarter.

"The dive in food prices over the last quarter can partly be explained by seasonal factors. Food prices tend to decline during the fourth quarter as the price of summer fruit and vegetables plummet," Frost says. "For instance, the cost of lettuce was down 64% and tomatoes were down 32% over the quarter. However, these declines do not tend to make food inflation negative for the quarter. Food prices have only declined six times during the December quarter in the last 50 years and this year's decline was almost twice the size of the next largest."

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