

What's Driving Food Price Inflation and Changing Consumer Behavior

Rising prices for food were an unavoidable part of public discourse in 2022, with food prices increasing by nearly 10% over the year. While the USDA said it expects food prices to grow at a slower pace in 2023 than in 2022, food prices are still anticipated to rise by a further 7.9% this year.

David Ortega, associate professor in the department of agricultural, food and resource economics at Michigan State University, joined Stable reporter Ingrid Lexova to discuss food price inflation, how it's changing consumer behavior, and the outlook for food prices in the near future.

The discussion was edited for length and clarity. You can access a full replay of the conversation below.

[IL] We've been hearing about higher food prices for quite a while now. One of the more prominent examples in recent memory have been egg prices. Looking at food prices overall, how fast are they still rising and how does that compare historically?

[DO] Food prices are up and they're up significantly. Food inflation has been outpacing the overall increase in prices for many months now. We're seeing price increases just about in every aisle of the supermarket. So today, food prices are 9.5% more expensive than they were a year ago and groceries in particular are rising a little bit faster and menu prices at restaurants are about 8.5% more expensive today than a year ago. To put this into perspective, for the five years or so before the COVID pandemic hit, food prices were increasing at around 2% year over year. So when we're talking about double-digit increases in grocery prices, that's a pretty significant departure from what was considered normal prior to the start of the COVID pandemic. We really haven't seen price increases of this magnitude with respect to food in just about over 40 years.

[IL] If we consider the wider food supply chain, if you look at transportation, labor, packaging, just to name a few factors there, we can really start to see how rising prices for food are really not just that; they're also a reflection of the wider economic reality. What would you say are the main drivers behind the rise in food prices that we're seeing today?

[DO] Well, the reason why food inflation has been so persistent is because we've seen a combination of factors and shocks that have really affected both the supply and the demand for food. This includes the effects of the COVID pandemic and what that did to consumer behavior, its effect on the workforce, as well as the supply chain disruptions that we saw, increases in transportation costs, labor costs and energy costs. All of these things were already on the rise prior to Russia's invasion of Ukraine just over about a year ago. That really affected commodity markets and has contributed to the current world food and energy crisis. That region, as many of us have come to know and learn about, is known as the breadbasket of Europe, a major supplier of grain as well as vegetable oils to the world market. And for the better part of last summer, Russia prevented a lot of that grain from leaving those important Black Sea ports. That grain started to move thanks to the grain deal

that was brokered and those commodity prices have come down quite substantially from their record highs earlier last year.

But it really takes time for these decreased costs to make their way down to the grocery store. Recently, the IMF put out a report that suggested that the pass-through of these high prices to consumers can take anywhere between six months to one year. So this is one of the main reasons why we haven't really felt much relief at the grocery store. It's also important to keep in mind that the ingredients in the food that we buy at the grocery store make up a small share of overall food costs. Roughly 15 cents out of every dollar that we spend on food can be tied back to on-farm activities. Everything else—the vast majority of the cost of food—is due to things that happen post-farm: a lot of the value added, the processing, transportation, as well as the wholesale and the retail trade. And we've seen increases all along those areas of the supply chain. We also have some category-specific events. You alluded to eggs earlier in our conversation. The high path avian influenza outbreak is now the largest in U.S. history and it's affected over 58 million birds, many of them in commercial operations. That's led to a significant rise in egg prices, which are just over 50% more expensive today than a year ago. But we've also seen increases in certain poultry items, like chicken, which is up 10% compared to the same time last year.

And then we have another factor on the supply side and that's the effects of climate change. We're seeing drought in parts of the U.S., the extreme heat that we saw out west last summer and for the past few years. But also in other important agricultural producing regions of the world, places like South America and Canada, we saw heat waves across Europe last summer and China experienced one of its hottest and driest summers on record. That drought, those heat impacts lead to less food being available, so lower productivity, lower yields, and that puts upward pressure on prices.

The last factor—which has received relatively less attention partially because of a lack of availability of data, which we've been starting to receive over the past few months—is increased consumer spending on food, which really impacts the demand side. Increased demand for food puts upward pressure on prices. And when we compare spending last year—2022—to spending on food compared to 2019, so prior to the COVID outbreak, consumers have spent more on food, even when you account for inflation, both on groceries and at restaurants. Part of this can be due to some of the excess savings that households accumulated during the pandemic as well as some of the fiscal stimulus. So when you take a step back, we have the supply shocks and supply factors as well as increased demand and spending on food. When you have both of these things, prices have nowhere to go but up. That's why we're seeing food prices increase at the rate that we're talking about.

[IL] And of course, as you alluded to as well, consumers are bearing the brunt of those higher prices. I'm no exception, I think many of us have fundamentally changed the way that we shop for food and what food we buy as a result of all of that. So how are consumers being impacted by the rise in food prices? And how has their shopping behavior changed?

[DO] These price increases are leading to changes in the way that we shop for food. So when we look at industry and point-of-sale data, it shows that consumers are bargain hunting. They're shopping around more, they're making more frequent and quicker trips to the grocery store, a lot more price comparison. So a lot less of the stocking up that we did pretty early on in the pandemic. We're also seeing increased demand for private labels and store brands which are sold at much more affordable price points. And quite simply, consumers are just trading down and trading out, taking fewer splurges when they go grocery shopping, as well as seeking much more value-oriented products and retailers. So they might be visiting much more of the value-oriented food supermarkets. And what's important to note here is that these changes in consumer behavior are really driven by low-income households and Americans, which spend a higher proportion of their income on food. The poorest 20% of households here in the U.S. spend over a quarter of their income on food. These individuals are the ones that are having to make some real trade-offs and tough decisions in order to put food on the table.

[IL] With all of that in mind, I think the obvious question is how food price inflation will continue to develop this year. Could you give us an idea of what to expect in terms of that food price inflation in the near future? When might we see prices start to come down?

[DO] As I mentioned earlier, we're looking at 12 months of double-digit inflation or increases in grocery prices. When we try to forecast into the future, it's really important to keep in mind what inflation really captures. It's the rate of increase in prices over a period of time, so how quickly prices are changing. It's a rate of change. Just because we start to see that inflation rate start to come down, it doesn't mean that things are getting cheaper. It just means that they are not increasing as quickly. When it comes to food prices, I expect them to remain elevated in the near term, certainly through spring and summer of this year. But that rate of increase, so the rate of food inflation, will continue to slowly come down. We saw a peak in terms of the food inflation rate back in August of last year. We're coming down from that peak, but prices overall are not going to go back to levels prior to the pandemic. That's because there's a general increase that happens through time with prices, but they will return to much more reasonable levels in the medium to long term.

We really have to address the underlying factors that I've been discussing, so it's really going to take resolving some of those factors before we're able to see some meaningful relief at the grocery store. The U.S. Department of Agriculture is predicting food prices to grow around 8% over the course of this year, but there's a lot of uncertainty, right? And this is barring any major new shocks or geopolitical conflicts. There's still a lot of uncertainty with the situation in Eastern Europe. There's a lot of uncertainty with how the avian flu is going to unfold this year and climate change and its effects are going to be with us into the future. I expect the rate of inflation to come down, but it's going to be quite some time, potentially even into next year before we start to get closer to that 2% year over year. And that would be sort of a best-case scenario. So really, really tough to predict, but I think there's some signs that we're headed in the right direction.