



GLOBAL ECONOMICS UPDATE

Is food inflation finally about to turn a corner?

- **While food CPI inflation remains very high in all major advanced economies – and especially so in Europe – we expect it to fall sharply in the coming year. Energy and labour costs have been key in keeping consumer food inflation so high, but these props should fade as the year progresses.**
- A surge in food inflation over the past 18 months has added a little over 1%-pt to average headline inflation in major advanced economies. **The increase has been particularly acute in Europe, where food and non-alcoholic beverages CPI inflation reached new highs of 17.5% in the euro-zone and 19.1% in the UK in March.** (See Chart 1.) At least in the euro-zone though, the flash April CPI release revealed that inflation for the broader basket of food, alcohol and tobacco fell for the first time in 18 months.
- If we look at comparable measures in the US and Japan – that is if we strip out “food away from home” from the US headline food CPI measure and “catering and alcohol” from that in Japan – then we can see that food inflation is also still rising in Japan, albeit from much lower levels. **But in the US, while food inflation remains high by past standards, it has actually been falling for the past seven months.** This divergence partly explains why headline inflation has been more persistent in Europe than in the US, where the fall in food & beverages inflation has knocked about 0.5%-pts off headline inflation since August.
- On the face of it, the ongoing strength in food & beverages CPI inflation across advanced economies is at odds with the falls in agricultural commodity prices over the past year. **Indeed, based on its historical relationship, the sharp fall in the y/y rate for the GSCI agricultural/livestock index has been pointing to a steep decline in the food contribution to DM headline inflation for some time now.** (See Chart 2.) This divergence has been starkest in the euro-zone and UK, but also notable in the US and Japan.
- **The fact that food inflation hasn’t fallen sharply yet is probably partly due to last year’s sharp rise in other input costs, such as those for labour and energy.** In the US and Europe, tight labour markets have fuelled strong wage pressures, which are keeping labour costs throughout both the food production and services supply chains elevated. For example, in the US wage growth in the accommodation and food service sector has been particularly strong, peaking at over 10% last year. That may help to explain why catering services inflation – which usually has a fairly strong relationship with food inflation – has barely fallen from its peak there. (See Chart 3.)
- Energy prices have also had a significant impact on food prices in general because of their importance for transportation, machinery and fertiliser costs. **The fact that energy inflation rose to particularly high peaks of 44% and 59% in the euro-zone and UK, respectively, helps to explain the relatively high rates of food inflation compared to those in the US and Japan.**
- But there is reason to believe that food inflation in Europe is finally about to follow that in the US and begin its descent. After all, energy inflation started falling several months earlier in the US than in Europe, with food inflation following suit shortly after. (See Chart 4.) **The recent plunge in energy inflation in the euro-zone points to a sharp decline in food inflation there too.** (See Chart 5.)
- Indeed, there is already some evidence that food inflation in Europe is turning a corner. The three-month annualised rates of food CPI – which provides a timelier gauge of turning points in inflation – have already fallen in both the UK and euro-zone. And even though both measures ticked up in March, they are still some way below their peaks from last year. (See Chart 6.) And in the euro-zone, given that the flash inflation data showed a fall in “food, alcohol and tobacco inflation” in April, we expect to learn from the more detailed final inflation figures released later this month that “food and non-alcoholic beverages” inflation fell as well.
- **So overall, there are clear reasons to expect that food inflation will soon fall in Europe. We expect falls in food inflation to reduce headline inflation in the euro-zone and UK by around 1.7%-pts each by the end of this year, compared to under 1%-pt in the US. A key upside risk to food inflation in both Europe and the US would be if labour markets remained exceptionally tight, keeping wage growth elevated.**



Chart 1: Food & Non-Alcoholic Beverages CPI (% y/y)

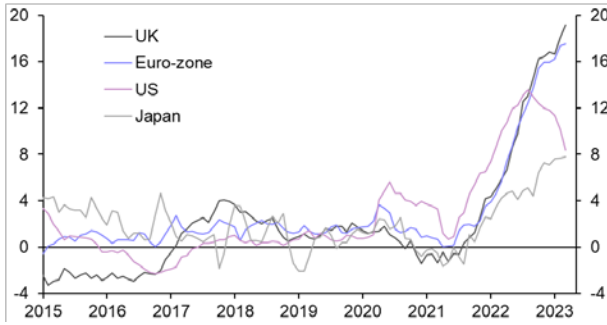


Chart 2: GSCI Aggs./Livestock & %-Pt Contribution of Food/Bevs. Inflation to Avg. Headline rate in Major DMs

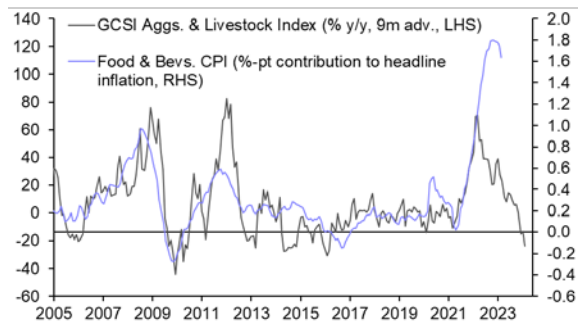


Chart 3: Catering Services CPI (% y/y)

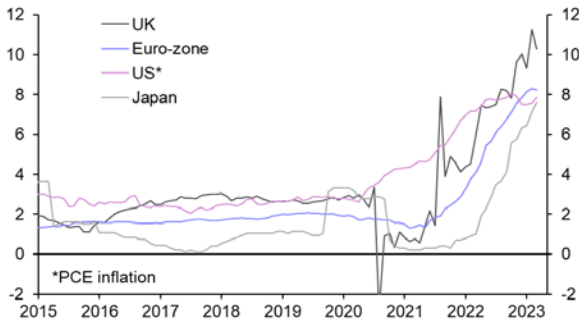


Chart 4: US Food & Beverages CPI & Energy CPI (% y/y)

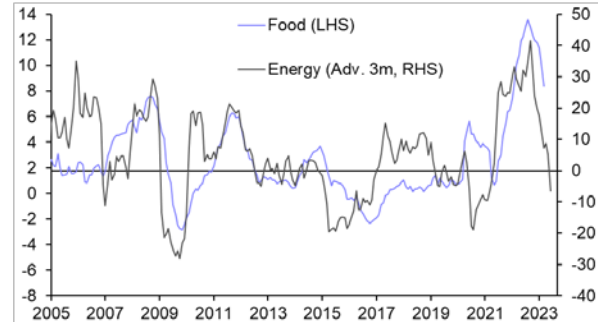


Chart 5: Euro-zone Food & Beverages CPI & Energy CPI (% y/y)

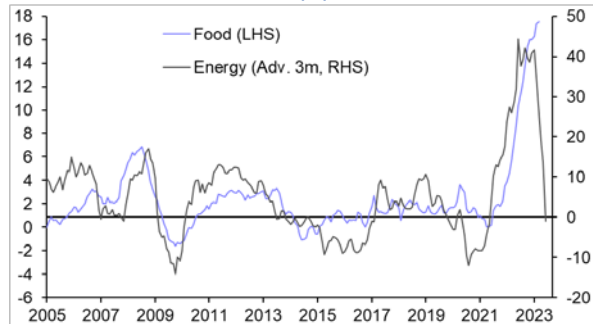
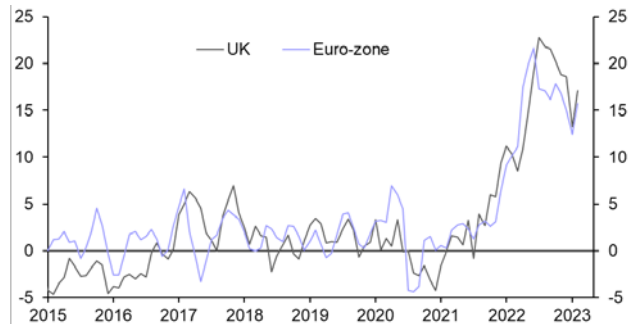


Chart 6: Food & Beverages CPI (SA, %3m annualised)



Sources: Refinitiv, Capital Economics



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