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Against the grain: Surging prices change food markets world-wide

Middle-class demand grows in Asia, Latin America; poor face more peril

By Scott Kilman

RISING PRICES and surging demand for the crops that supply half of the world's calories are producing the biggest changes in global food markets in 30 years, altering the economic landscape for everyone from consumers and farmers to corporate giants and the world's poor.

"The days of cheap grain are gone," says Dan Basse, president of AgResource Co., a Chicago commodity-forecasting concern.

This year, the prices of Illinois corn and soybeans are up 40% and 75%, respectively, from a year ago. Kansas wheat is up 70% or more.

And a growing number of economists and agribusiness executives think the run-ups could last as long as a decade, raising the cost of all kinds of food.

In the past, such increases have been caused by temporary supply disruptions. Following a poor harvest, farmers would rush to capitalize on higher crop prices by planting more of that crop the next season, sending prices back down. But the current rally, which started a year ago in the corn-futures trading pit at the Chicago Board of Trade, is different.

Not only have prices remained high, but the rally also has swept

up other commodities such as barley, sorghum, eggs, cheese, oats, rice, peas, sunflower and lentils. In Georgia, the U.S.'s No. 1 poultry-producing state, slaughterhouses are charging a record wholesale price for 1.4-kilogram chickens, up 15% from a year ago.

What has changed is that powerful new sources of demand are emerging. In addition to U.S. government incentives that encourage businesses to turn corn and soybeans into motor fuel, the growing economies of Asia and Latin America are enabling hundreds of millions of people to spend more on food. A growing middle class in these regions is eating more meat and milk, which in turn is increasing demand for grain to feed livestock. In the U.S., a beef cow has to eat roughly six kilograms of grain to put on a kilogram of weight, and a hog about four kilograms.

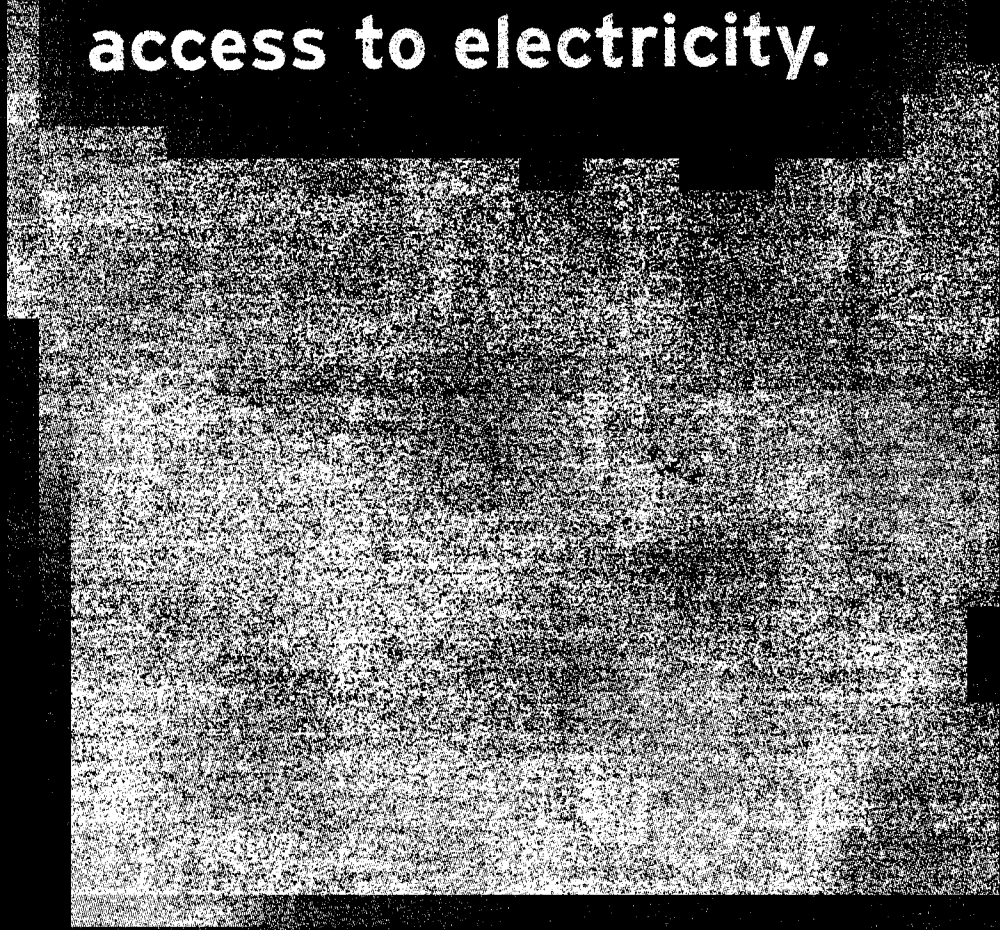
The reversal of a long-term trend toward lower grain prices



Reuters

A member of an Italian consumer association, left, gives free pasta to a woman during a protest in Rome last month over an expected price spike.

**Two billion people
are currently without
access to electricity.**



could have profound effects on the world's ability to feed its poor. Global grain stockpiles are being drawn down to their tightest levels in three decades, leaving the world vulnerable to shocks brought on by bad harvests. And it is far from clear how much more land could be brought into production or to what extent advances in biotechnology might increase crop yields in the future.

American families, which spend 9.9% of their disposable income on food, are facing the fastest-rising food prices in 17 years. The consumer's cost for everything from yogurt and popcorn to breakfast cereal and fast-food french fries is climbing. In U.S. cities in August, the average retail price of a loaf of whole-wheat bread was up 24% from a year ago, according to the U.S. Bureau of Labor Statistics. Whole milk hit \$1 a liter, up 26%.

Similar increases are showing up outside the U.S. Italian shoppers are protesting soaring pasta prices, and Mexican authorities have capped the price of corn tortillas. Pakistan is curbing wheat exports to counter rising food-price inflation while Russian authorities, worried about rising bread prices, are considering a similar clampdown.

Food companies are struggling to figure out how to pass on higher costs to supermarkets and restaurant chains, which have gotten bigger and thus gained clout since the last prolonged rise in food prices in the 1970s.

"We're in uncharted territory," says Christopher Fraleigh, chief executive of the food and beverage division of Sara Lee Corp., which raised its bread prices 5% last month.

The biggest winner is the U.S. Farm Belt, which is primed for an unusually long expansion, even as a nationwide housing slump damps the broader economy. The

Agriculture Department expects U.S. net farm income to soar 48% this year to a record \$87.1 billion.

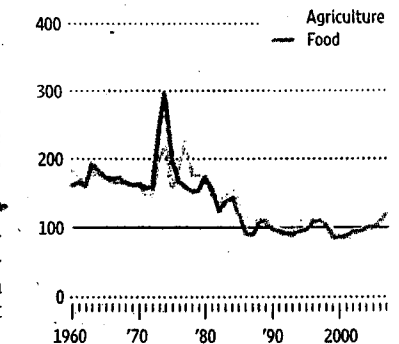
"I sold wheat here just the other day for \$7 [a bushel]. That's the first time I've ever done that," says Doyle Johannes, a fourth-generation grain farmer in Underwood, North Dakota. With prices so high, he bought his first new harvesting combine, a \$250,000 Caterpillar decked out with computerized controls and a built-in cooler.

< An expected spending spree by farmers is igniting the stocks of several farm suppliers. Shares of implement maker Deere & Co. are up about 76% from a year ago, while seed-and-herbicide giant Monsanto Co.'s stock is up 79%, and fertilizer maker Mosaic Co.'s shares have more than tripled.

The grain rally shows few signs of slowing even though U.S. corn farmers are expecting a record harvest. Futures traders are betting that the price of corn, used for everything from sweetening soda to putting the crunch in snack foods,

Reversing the trend

Price indexes for commodities exported to the developing world, adjusted for inflation*; 1990=100



*Deflated by an index of U.S.-dollar values of manufactures exported by the G-5 countries, weighted proportionally to the countries' exports to the developing countries.

Source: World Bank

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So far, the burden of higher grain prices is falling heaviest on small businesses, which don't have the wiggle room that large companies do.

Hit by a 35% increase in wheat-flour costs since December, Michael Kalupa, owner of Kalupa's Bakery in Tampa, Florida, said he has put off plans to buy a new walk-in refrigerator. "Guys like us pretty much have to bite the bullet," said Mr. Kalupa, president of Retail Bakers of America, a bakers trade group.

—Lauren Etter, Julie Jargon, Roger Thurow and David Kesmodel contributed to this article.

erode the buying power of the world's hungry.

Humanitarian groups are cautioning that their budgets for food aid won't go nearly as far as they did in the past. Roughly 200 million of the 850 million malnourished people in the world's poorest nations receive some food assistance. "My major concern is that we will lose ground against hunger," says Josette Sheeran, executive director of the United Nations' World Food Program.

That outlook is increasing the urgency of nascent efforts to end food shortages in sub-Saharan Africa, the one region in which hunger is worsening. "I think we are going to be facing a food crunch," says former U.N. Secretary-General Kofi Annan.

"So we have to really take charge and begin to produce our own food," Mr. Annan, a Ghanaian, said during an interview at his Geneva office, where he heads a push by the Bill and Melinda Gates Foundation and Rockefeller Foundation to help bring to Africa the agricultural revolution that spread across Asia and Latin America decades ago.

U.S. farm exports, meanwhile, are climbing, dousing the fears of just a few years ago that the U.S. farm sector was on the verge of generating a trade deficit. Agriculture Department economists ex-

pect exports to hit a record \$79 billion in the year ending Sept. 30, up 15% from last year.

For food-company executives, life is getting more complicated. "One year it's oil, the next it's grain," says General Mills Inc. Chief Executive Kendall Powell. "But it's all underpinned by one thing: strong global demand for those commodities." The U.S. food giant, which had sales of \$12.4 billion in its latest fiscal year, expects raw-material costs in the fiscal year ending in May to jump \$250 million, mostly due to costlier farm commodities.

To cope, General Mills is shrinking the size of its breakfast-cereal

packages, effectively raising the price per gram. At a Dominick's supermarket in suburban Chicago, a 440-gram box of Wheaties recently cost \$5.16, more per gram than the round steak London broil at the meat counter. Grain typically has accounted for a small part of the cost of packaged products like bread and ready-to-eat cereals.

Fast-food chain Burger King Corp. is importing more grass-fed beef to make its U.S. hamburgers, and its Asian outlets are switching to french fries made from less-expensive New Zealand potatoes rather than Washington state spuds.

will climb above \$4 next March and stay above that level into 2010. In recent days, Iowa farmers have been selling corn for \$3.25 a bushel.

Next year is shaping up to be the third in a row in which the world consumes more grain to make fuel, food and livestock feed than it harvests. The trend is helping reduce global grain stockpiles to their lowest point relative to consumption since the mid-1970s, when Asia struggled with chronic food shortages and the Soviet Union suddenly emerged as a big grain importer.

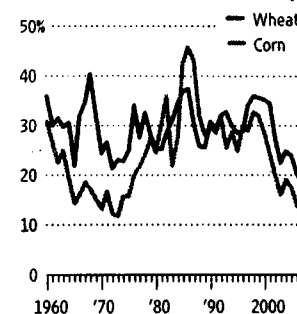
Part of the reason for the draw-down can be seen in China, where soaring demand for milk has increased the number of dairy cattle threefold so far this decade. Half of the world's hogs now live in China, which is importing about 13% of all the soybeans grown in the U.S. to help fatten its livestock. The Chinese government, caught off guard by a nearly 50% rise in retail pork prices, is throwing cash at farmers willing to produce more of the nation's most widely consumed meat.

The prospect for a long boom is riveting economists because the declining real price of grain has long been one of the unsung forces behind the development of the global economy. Thanks to steadily improving seeds, synthetic fertilizer and more powerful farm equipment, the productivity of farmers in the West and Asia has stayed so far ahead of population growth that prices of corn and wheat, adjusted for inflation, had dropped 75% and 69%, respectively, since 1974. Among other things, falling grain prices made food more affordable for the world's poor, helping shrink the percentage of the world's population that is malnourished.

The recent grain drain has stirred a new set of worries in the developing world. Developing nations used to complain their farmers were hurt by rich subsidies offered to producers in the U.S. and European Union, which encouraged price-depressing gluts. Now, their concern is shifting to how sharply high grain prices will

Grain drain

Global demand is leaving end-of-year grain inventories at levels that are less than 20% of the total amount used each year; stocks as a percentage of use



Note: 2007 figure is a projection
Source: U.S. Department of Agriculture