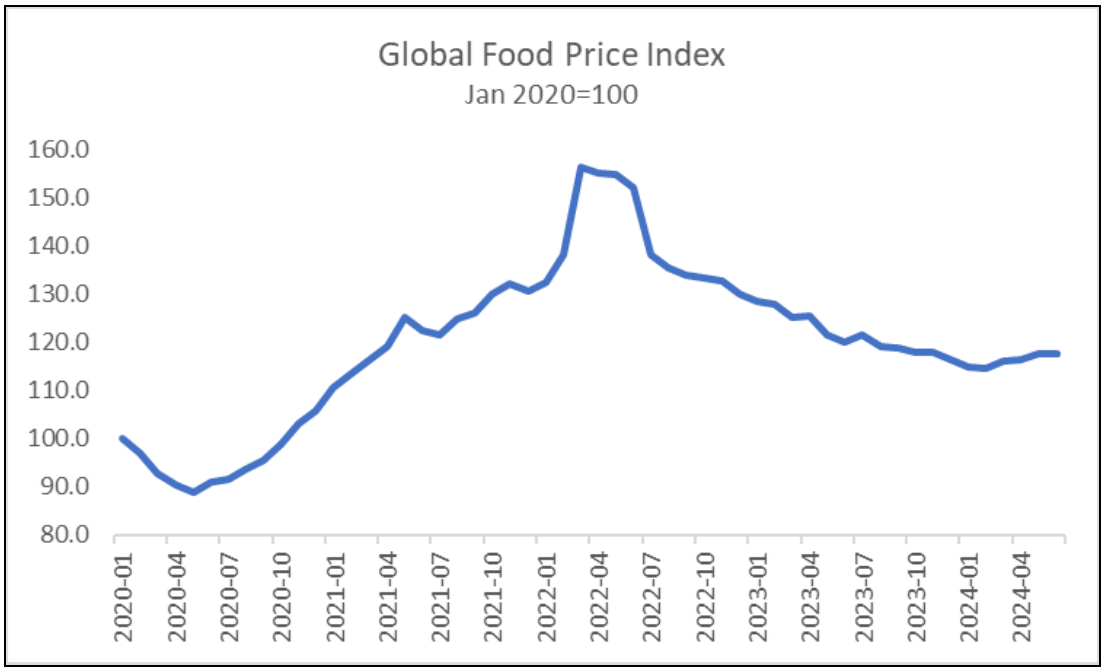
Why do Domestic Food Prices keep going up when Global Prices Fall?*

C.P. Chandrasekhar and Jayati Ghosh

In the past three years, global food prices have been on a roller coaster, rising rapidly especially in the first half of 2022 due to a speculative bubble and then falling from July 2022 onwards (Figure 1). The phase of rising food prices led to increasing food prices around the world, especially in lower income countries—and this was obviously associated with growing hunger. According to the FAO, 122 million more people faced hunger in 2022 than in 2019, before the global pandemic. Around 42 per cent of the world's population—more than 3.1 billion people—were unable to afford a healthy diet in 2021.

Figure 1.



Source: https://www.fao.org/worldfoodsituation/foodpricesindex/en/

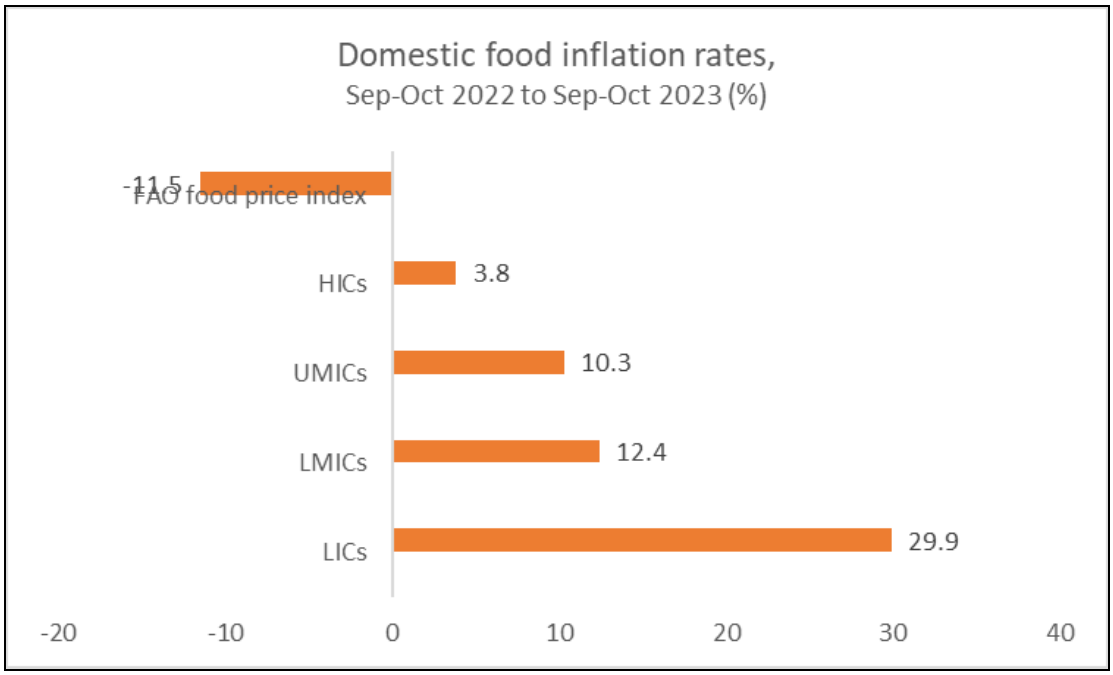
The dramatic rise in global food prices (especially for wheat) in the first half of 2022 was largely attributed to the Ukraine War, which was supposed to have affected supply because of Russia and Ukraine being major wheat exporters. But it is now clear that global supply was largely unaffected in this period, because of increased production in other countries. Instead, the rise in prices can be attributed to the combination of profiteering by large agribusinesses in the oligopolistic international food trade, and financial speculation in food commodity futures (see **UNCTAD's** Trade and Development Report 2023 for details).

Some observers have argued that, even if this is true, it should not be such a big concern because the prices came down quite rapidly thereafter—indeed, by early 2024 the FAO's food price index was back to the level of two years earlier. Unfortunately, however, the transmission of global food prices to domestic prices tends to be uneven: domestic prices rise when the global prices rise, but they do not

necessarily come down, and may even continue to increase, as international prices fall.

This is evident from Figure 2, which shows the behaviour of domestic food price changes during the recent period of global food price decline. The FAO's global food price index fell by 11.5 per cent in the year up to Sep-Oct 2023, but domestic prices across all groups of countries continued to rise. Significantly, the food price inflation was higher, the lower the per capita income of the country. For the Low Income Countries, food prices increased on average by just under 30 per cent in this period. Note that this came on the back of earlier food price increases when global trade prices increased, together providing real and continued blows to food security. In lower income countries, between 30 to 60 per cent of consumer spending is devoted to food (compared to 10-20 per cent in higher income countries), and the proportion rises for the lower income categories within each country.

Figure 2.



Source: https://www.ifpri.org/blog/despite-improved-global-market-conditions-high-food-price-inflation-persists/

This ratchet effect in domestic food prices means that even temporary spikes can be dangerous and reduce food security over time. So we cannot afford to be complacent about short-term price increases, since they continue to have medium term effects. To address this, both price volatility in the global food markets and the transmission of price changes to domestic markets must be addressed.

So why do domestic food prices continue to increase? There are several reasons, which reflect the interplay between physical supplies of food and market behaviour. The domestic availability of food is determined by local and national production (in which weather and climate shocks, agroecology, and conflicts all play a part) as well as a country's ability to import food (which can be affected by transport shocks as well as foreign exchange constraints). It is clear that, while both have been important,

external shocks have been the major drivers in the recent period, particularly through factors that have caused currencies to devalue in lower income countries.

Table 1 shows that countries that experienced particularly high food inflation in the year up to September 2023 (that is, more than 20 per cent) also suffered very large nominal currency depreciations (here shown relative to the IMF's SDR, which is a basket of five major currencies).

Table 1: Countries with high food inflation (>20%) up to Sep 2023

	Food inflation	Nominal exchange rate depreciation
Venezuela	318.1	n.a.
Argentina	150.1	143.9
Turkey	75.1	52.0
Egypt	73.6	62.4
Sierra Leone	64.7	45.7
Syria	60.3	n.a.
Suriname	59.6	48.2
Ghana	49.6	22.9
Iran	37.7	2.7
Nigeria	30.6	81.6
Ethiopia	27.1	8.4
Pakistan	26.8	29.7
Zimbabwe	23.5	803.6

Sources: Calculated from

1. https://www.ifpri.org/blog/despite-improved-global-market-conditions-high-food-price-inflation-persists/ for domestic food inflation rates

2. https://data.imf.org/regular.aspx?key=63140098 for nominal exchange rates (relative to SDR)

Why did these currencies depreciate so much? This mostly reflects changes in the global economy rather than in these countries. The easy money policies and low interest rates in rich countries in the 2010s made banks and financial institutions flush with funds, and allowed many LMICs that earlier were not attractive to private finance to access credit and bond markets. But from 2020, a series of shocks (the Covid-19 pandemic, Ukraine war, tighter monetary policies and higher interest rates in advanced economies) meant a reversal of these processes, causing net capital outflows. This also worsened the terms on which capital flowed into these economies, with higher interest rates on debt and much higher spreads on their sovereign bonds.

This created debt stress in at least 70 countries, and caused currencies to depreciate across the board, making imported food costlier. Even countries that are not net importers of food found that their domestic prices were badly impacted by currency depreciation. So capital flows in lower income countries need to be regulated, if only for reasons of food security!

However, if we exclude the hyperinflationary cases of Venezuela and Argentina, in most cases (other than Nigeria and Pakistan) the exchange rate decline was not enough to explain the continuing food price rise, even though it surely contributed to

it. (The other outlier, Zimbabwe, is almost a dollarized economy because of domestic hyperinflation, which is why food price inflation was comparatively lower than the others in this group despite massive currency depreciation.)

This means that for the worst affected countries, there are other factors at play. One important factor is debt distress: many debtor countries have to pay so much as debt service that they cannot import sufficient food to keep domestic prices down. Egypt, Suriname, Ghana and Nigeria fall into this category.

Then there is the effect of western sanctions in countries like Venezuela, Iran, Syria. The worst impacts of sanctions are felt by the poor, who are hungry because of domestic food (and medicine) shortages.

But beyond these extreme cases, many other lower income and middle income countries face similar problems. Reliance on global markets for both food and finance is proving to be extremely problematic. For minimal resilience in the face of such shocks, it is now important for countries to protect themselves by striving for domestic food sovereignty, regional arrangements to ensure supply, and capital controls to reduce currency volatility.

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