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Global Food Price Volatility and Implications for Cambodia

Summary

The global food prices have risen sharply since July 2010 to a level that already slightly surpassed the 2008 peak. The new peak has been primarily driven by sharp rises in prices of wheat and maize. Prices of rice have had a modest increase.

Despite on-going concerns over soaring in global food prices, food prices in Cambodia have remained largely stable thanks in part to good harvest of rice and moderate demands from neighboring Vietnam and Thailand. Moreover, the situation for this year is different from that of 2008. We saw domestic overheating is a factor that adds to raising prices of oil and food in 2008, but, at the moment this is not the case.

As a result of lower demand of paddy from Vietnam and Thailand, it seems likely that Cambodia paddy flows to the neighboring countries have slowed significantly in spite of increasing exportable surpluses and prices of paddy have been reportedly 10-15% lower than a year earlier.

So far the RGC has restrained from interfering directly into domestic paddy prices. This is laudable and Government should be commended for this, given that the tight fiscal space makes it difficult to dramatically increase public spending levels any time soon without substituting on-going investments into productive infrastructure and human capital development, which are critical for long term competitiveness of Cambodian agriculture and rice sector specifically. The agriculture Public Expenditure Review analysis shows that public spending has been important for stimulating supply response in Cambodia, especially in rice sector, which makes up half of crop in GDP. Total Government funding for agriculture, irrigation and rural roads sectors increased from Riel 464 billion in 2007 to Riel 644 billion in 2009. This is equivalent to 1.5% of GDP.

In the immediate term, given uncertain situation around global food and oil prices, it is required to keep the efforts of monitoring prices and flows of rice as well as moves by major exporters and importers.

In the medium term, one of the key issues for Cambodia competes for a share in international market is strengthen the capacity of rice millers and traders to be able to deliver large contracts.

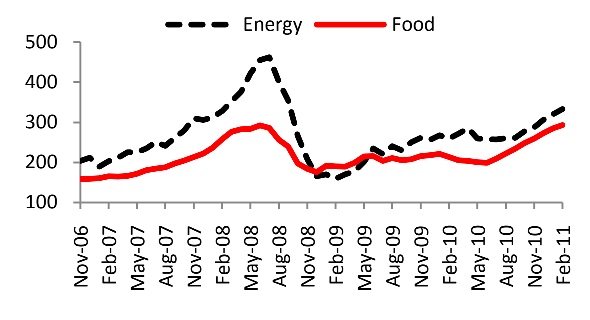
Global Food and Fuel Prices Situation

The global food prices have risen sharply since July 2010 to a level that already slightly surpassed the 2008 peak. The World Bank's global food price index in February reached 293 points, up for the eighth straight months since July last year. This level has slightly surpassed the highest in 2008 food crisis when we saw the index reached 292.6 points in June.

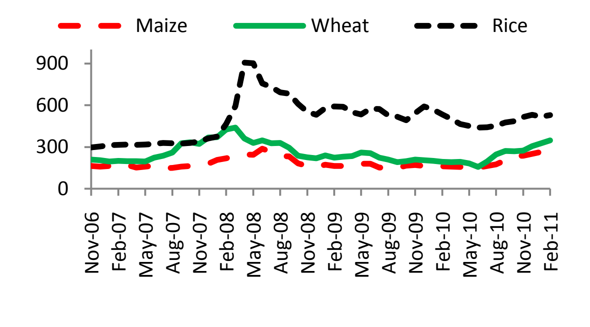
The new peak in the overall index has been primarily driven by sharp rises in prices of wheat and maize. Prices of rice have had a modest increase. Between July 2010 and February 2011, while prices of wheat surged by 52-78% and maize by 80%, rice rose by only 20-34%. Rising prices in wheat were due to weather problems in major producing countries and followed by export restrictions by major producers such as Russia and Ukraine. For corn, apart from bad weather that caused supply shortfalls, turning corn to ethanol is another factor to blame. For instance, the US - the world largest exporter – turns its 40% of corn production this year into ethanol for car engines. For rice, main reasons that price rises haven't matched with those of wheat and corn are because a/ Carry-in stocks by many countries are large; b/ there is no shortfalls in global production thanks to good harvests in key producers in Southeast Asia; c/ No major exporters have announced export bans while none of major importers have rushed to buy for stockpile, moves that created panics in markets in 2008.

Figure 1: Global food and energy prices

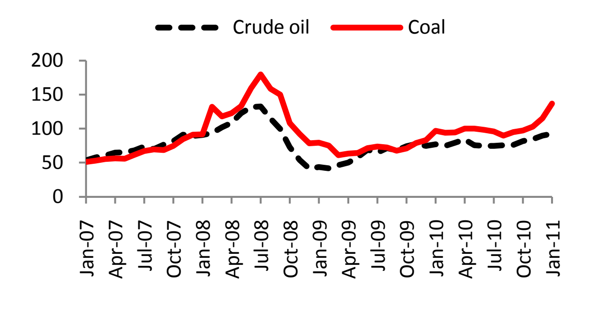
a/ Food and energy price indices, 2000=100



b/ Wheat, maize and rice prices (US$/mt)



c/ Prices of crude oil (US$/bbl) and coal (US$/mt)



Source: World Bank, Development Prospects Group

More recently, world prices of rice continue to weaken due to promising supplies in March/April harvests in Thailand and Vietnam, amid limited recent sales and further delays in buying by the Philippines. The weekly export quotations in Thailand on March 09 have declined to US$ 485 for Thai 5% rice and US$ 475 for Thai 25% rice or 5% and 2% when compared to average prices in February. Export quotations for Vietnamese 5% fell to US$ 440, down by 4% from February.

Global energy index also has increased markedly due to rising prices of crude oil and coal, yet it is still far below its peak in 2008. The World Bank's energy index has increased to 333 points in February, up for the seventh straight month. The current level, however, remains 27% below its peak in July 2008. The reason that has caused a rise in the overall index is he surge in prices of crude oil and coal due to on-going social unrests and escalation of violence in the Middle East and North Africa and floods in Australia. Crude oil prices averaged US$ 98/barrel in February, rose for the seventh straight months. For coal, prices dropped to US$ 125/ton after climbing to US$ 137/ton in January due to severe floods in Queensland State of Australia and weather-related problems in major producing countries such as Colombia, Indonesia, Russia and South Africa.

Local Food and Fuel Prices Situation

Despite on-going concerns over soaring in global food prices, food prices in Cambodia have remained largely stable thanks in part to good harvest of rice. Calculation of price information from the National Institute of Statistics showed that food inflation rate from July to December 2010 averaged 3%. This level is judged to be a stable situation given we saw a rate of 31% for the same period in 2008 and what is happening with global food prices now. In January, food prices in Cambodia continue to show no signs of running after the sharp upward trend in global food situation. Food inflation increased by 3.6% compared to a year earlier.

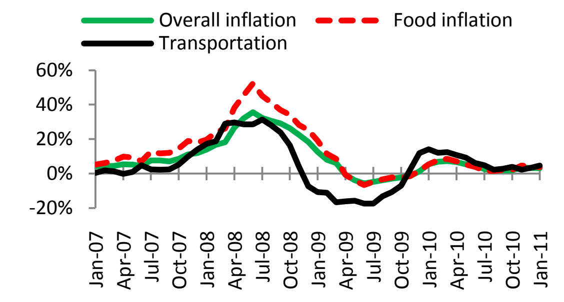
The current situation of food prices is primarily due to stability of rice prices after having had good harvests in 2009/2010 and 2010/2011 seasons. Price of Cambodia white rice Phaka Kanhey averaged Riel 2,681/kg between July and December 2010 and remains low at Riel 2,660/kg in January. Furthermore, for last year prices were not seen to have notable increase in the pre-harvest period, which is unusual. This seems to suggest that households were better preparing after experiencing price shock in 2008.

For other important foodstuffs such as pork, beef, chicken, situation of price has been mixed. Prices of pork, beef and chicken has been generally stable while price of fish was up sharply in third quarter of last year but dropped afterwards because of fishing season.

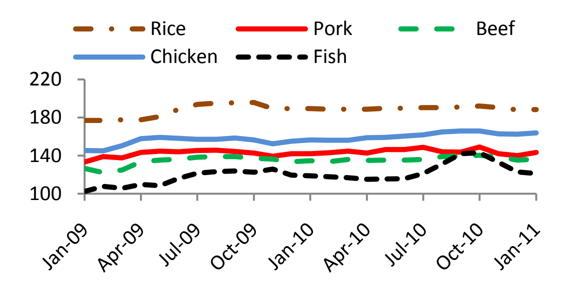
Another factor to note is the situation for this year, which is different from that of 2008. In 2008, in addition to external push in raising prices of fuel and food, there was domestic overheating. Banks lent to private sector grew more than 100%. At the moment, it grows less than 30%. Given the economic recovery is under way, it is worth monitoring as this could be a potential source of inflation.

Figure 2: Prices of food and fuel in Cambodia

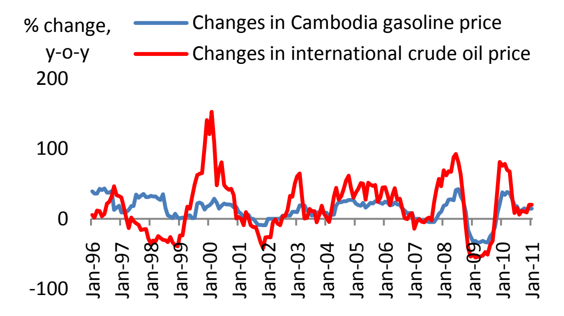
a/ Rates of inflation by main categories (year-on-year)



b/ Indices of important food items, Oct-Dec 2006=100



c/Changes of fuel prices (year-on-year)



Source: Consumer Price Index, National Institute of Statistics, Ministry of Planning

Apart from Cambodia's bumper harvest this year, another reason for low prices of rice for this year were driven in part by moderate demands from neighboring Thailand and Vietnam due to their large carry-over reserves and uncertain future orders from key partners. Thailand, for example, has released nearly 5 million tons of rice since September last year. It now keeps only 100,000 tons as food reserves as they expect to have good harvest in March/ April. The Philippines has not rushed to buy for stockpile and only very recently announced to import around 0.7-1 million tons for this year, roughly a third of the volume they bought in 2009/2010. The Philippine Government has had talks with Thailand and Vietnam, but it has reported that they have not sealed any contracts.

The weaker demand from the Philippines is sufficient to offset stronger demand from Indonesia, which appears to step up its buying efforts for reserve, and was reportedly reached agreements with Vietnam and Thailand to import about 1.8 million tons, up from 1.1 million tons from 2009/2010.

As a result of lower demand of paddy from Vietnam and Thailand, it seems likely that Cambodia paddy flows to the neighboring countries have slowed significantly despite of increasing exportable surpluses. Since the beginning of 2010 harvest season, Ministry of Agriculture, Forestry and Fisheries has strengthened its efforts to track volume and direction of paddy outflows. The on-going attempt to track the outflows revealed that by mid February around half millions of paddy had been transported to Vietnam and Thailand. This amount accounts for 6% total production and 13% of exportable surplus this season. If comparing to total annual outflow that was observed in most recent years, this is only one fifth. This would imply that large volume of paddy remains in the country.

Despite recent picking-up in flows to Thailand through Banteay Meanchey, flows to Vietnam still accounted for more than 90%. Up to mid February, flows to Vietnam remains accounted for more than 90% of total outflow despite flows to Thailand has been picked up recently through Thnung border gate in Thma Puok district of Banteay Meanchey.

While lower rice prices this year make urban population and rural landless households – together accounted for 30-40% of households in Cambodia– happier, another 1/3 who believed to have surplus are reportedly disappointed.

Various local media reported in January that prices farmers got this year were 10-15% lower than those in the corresponding period a year ago. For farmers who need quick cash, they sold at these prices, but for some they are holding back their sales.

Table 1: Paddy outflows from Cambodia to neighboring countries as of February 16, 2011

	Volume of paddy (mt)	Share (%)
Svay Rieng	140,830	29%
Takeo	128,537	27%
Banteay Meanchey	59,082	12%
Prey Veng	111,041	23%
Kampong Cham	2,500	1%
Kandal	16,675	3%
Kampot	25,115	5%
Total	483,780	

Source: MAFF, Monthly Report of Paddy Outflows and Prices

Because the global wheat and maize prices continued to rise and many analysts predict this trend would sustain, switching from consuming these staples to rice is quite possible. This combines with rising in fuel prices pose a threat to the stability of rice prices in the coming months. There is a possibility that consumers in some countries, particularly in Africa and South Asia, would switch to eat rice given higher prices in wheat and maize. If this holds, rice price will be likely to increase sharper from the current level. On the other hand, there are concerns over spiral effects to rice from the spike in crude oil prices due to escalation of unrests and violence in the Arab world. In January, average price of regular gasoline was at Riel 4,700/liter but as of February 28, 2011 the price increased to Riel 4,800/liter (up by 2%) and more recently rose to Riel 4,900/liter.

Historically and particularly in 2008, there was a quick pass-through from rising in crude oil prices to local users and productions. So, this year is not exceptional. It is possible that impacts will be obvious and greater if the spike sustains. In Phnom Penh, for example, average households spend around 5%

of total consumption expenditure on gasoline, according to Consumer Price Index from National Institute of Statistics.

So far the RGC has restrained from interfering directly into domestic paddy prices. This is laudable and Government should be commended for this, given that the tight fiscal space makes it difficult to dramatically increase public spending levels any time soon without substituting on-going investments into productive infrastructure and human capital development, which are critical for long term competitiveness of Cambodian agriculture and rice sector specifically. International evidence shows that in countries where Governments have interfered in domestic input and output markets, at the expense of other public investments, it has created heavy cost to the rest of the economy while generating little expected benefits. For example, in allocating public funds for agriculture many governments have chosen to spend their limited agricultural budgets on subsidies for private farm inputs, such as seeds and fertilizer, while spending far less on rural infrastructure and technology development. Yet, international evidence suggests that returns to private input subsidies are typically lower than returns to investments in public goods, in part because private input subsidies are prone to rent-seeking and in part because public input subsidies substitute for private financing of these private inputs. For example, Lopes et. al. (2006) empirically documents that the government's decision to subsidize either private goods has negative consequences for economic development. Furthermore, analytical evidence shows that expenditures on private goods have in many cases negative returns, due to high levels of leakages crowding out of private input purchases, resource misallocation and consequent inefficiencies in input use. For example, estimates from 15 Latin American studies indicate that a 1% increase in budget share for agricultural input subsidies reduces per capita agricultural income by 0.3% to 0.5% (Lopez, 2005).

On the other hand, international experience shows that expenditures on public goods, such as agricultural research, extension and farmer education and training, and rural infrastructure do help to increase agricultural growth and competitiveness. For example, agricultural research and extension typically generate the high returns of any form of agricultural spending. A recent summary of over 600 studies suggests that returns to agricultural research average 50% in Africa, 78% in Asia and 54% in Latin America (Allston et al, 2005). Public investment in roads and irrigation, likewise, generates strong returns (Fan et al, 2004). Similarly, investment in irrigation infrastructure has proven profitable in many circumstances and generated expected supply responses when well managed.

The agriculture Public Expenditure Review analysis shows that public spending has been important for stimulating supply response in Cambodia, especially in rice sector, which makes up half of crop in GDP. Total Government funding for agriculture, irrigation and rural roads sectors increased from Riel 464 billion in 2007 to Riel 644 billion in 2009. This is equivalent to 1.5% of GDP. Irrigation and rural roads have been given priority in the small but expanding government capital budget. Budget for irrigation increased from Riel 17.9 billion in 2004, to Riel 148.7 billion in 2009 while capital expenditure for Ministry of Rural Development which is responsible for rehabilitation and maintenance of rural roads, has increased from Riel 64.7 billion to Riel 87.6 billion over the same period. Although public spending on extension and research has been relatively small - only 8% of the budget of Ministry of Agriculture, Forestry and Fisheries - it has had a positive effect on improved rice yields which have been growing at the annual rate of about 3% over the last decade.

In the immediate term, given uncertain situation around global food and oil prices, it is required to keep the efforts of monitoring prices and flows as well as moves by major exporters and importers. For international rice situation, Bangkok and Ho Chi Minh are markets that analysts and traders used as basis to benchmark their prices. As observed in 2008, markets could become turmoil quickly if major exporters impose bans or major importers to buy with large quantity. It is, therefore, important to monitor trade measures imposed by major countries in the region.

In the medium term, one of the key issues for Cambodia competes for a share in international market is strengthen the capacity of rice millers and traders to be able to deliver large contracts. As a new entrant to global rice market, Cambodia has not been able to reach any Government-to-Government contracts, largely due to logistical difficulties and inability to deliver a required quantity and quality of milled rice. But, like nature of any business, importing countries always look for an alternative source of supply who can give a better deal. By then, local rice millers and traders must be ready for delivery.

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