

Viewpoint

Special

June 2023

Exploring what's next for food inflation

Economics from **IGD**



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The outlook for food inflation



Food and drink inflation has broadly followed IGD's previous forecast, [published in November 2022](#). Food inflation was expected to peak in Q1 2023 between 17% and 19% on the CPI method, before declining over the year.

IGD still expects that food price inflation will slow as 2023 progresses. In our revised forecast food inflation is expected to decline from a probable peak of 19.1% in March 2023 to 8-10% in December 2023, 1% higher than our previous forecast.

Average whole year food price inflation will be 14-16% for 2023 and 1-3% for 2024.

Our latest forecasts indicate that food inflation will be higher than previously forecast up until the end of Q1 2024. This is due to:

- High inflation in Q1 2023 – food price inflation came in at the top of IGD's estimates, making it more likely to remain high at the end of the year
- Persistently high input costs for food and drink manufacturers, especially for raw materials and labour
- Intense pressure on margins across the food supply chain, with many businesses still needing to pass on historic cost changes

Our forecasts indicate that food inflation will remain above zero until at least the end of Q2 2024. Food prices will continue to rise in that period but at a lower rate. We expect the cost of a typical shopping basket to begin to decline from Q3 2024.

What's happening?

Over many years, a very competitive food industry has seen food prices rise behind the general cost of living, meaning that food has effectively become cheaper over time.

The outbreak of conflict in Ukraine in March 2022 shocked global commodity and energy markets and disrupted supply chains.

The spike of food price inflation experienced over the past year is unprecedented for the modern food industry.

In the UK the consequences have been significant. [Real household incomes](#) fell in 2022 and are expected to fall substantially in 2023 and 2024.

Food inflation has proved surprisingly persistent in recent months. In April food inflation reached [19%](#), the second highest level in 45 years, considerably higher than the overall inflation rate of 8.7%.

Food price inflation is expected to continue to be broad based across the majority of categories. Meat, fish, dairy, bread and cereals are forecast to provide the strongest contributions.

Our latest forecasts predict that marginal food price deflation will take place from Q3 2024. It is uncommon for periods of food price deflation to take place in the UK, there has only been one period in the past 50 years.

Why it matters

Food and non-alcoholic beverages make up around 10% of the ['basket of goods and services'](#) that makes up the CPI index. Price changes for food therefore play a powerful role in driving overall inflation.

The average household [spent](#) 14.4% of their budget on retail food and non-alcoholic drinks in 2020/21. This increased to 18.3% for the lowest 20% of households by equivalised income.

The significant inflation in food has meant that it is now the second largest contributor to the overall inflation rate, behind household energy.

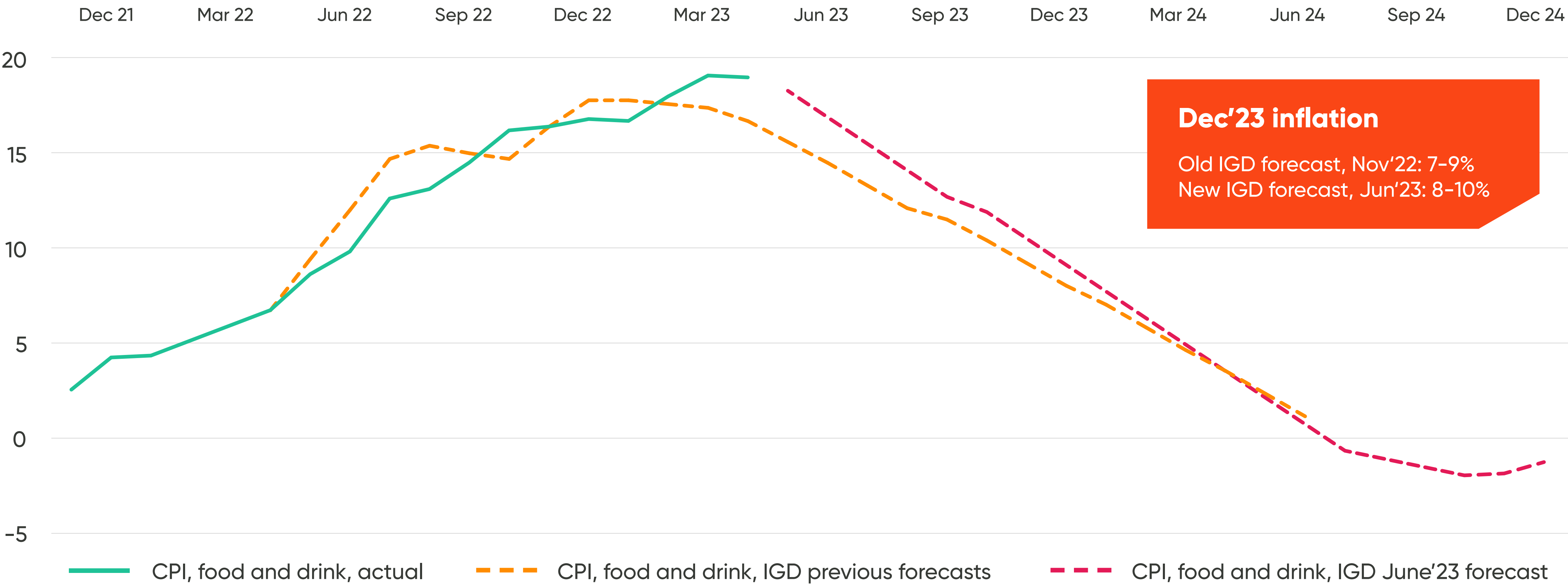
Food and drink is predicted to contribute 47% of overall inflation by Q1 2024 compared to 21% in Q1 2023. Food's contribution to overall inflation is higher than the [Bank of England's](#) overall target of 2% for the entire 'basket of goods and services'.

Data at a glance

Food price inflation forecast

Year-on-year inflation, CPI method (%)

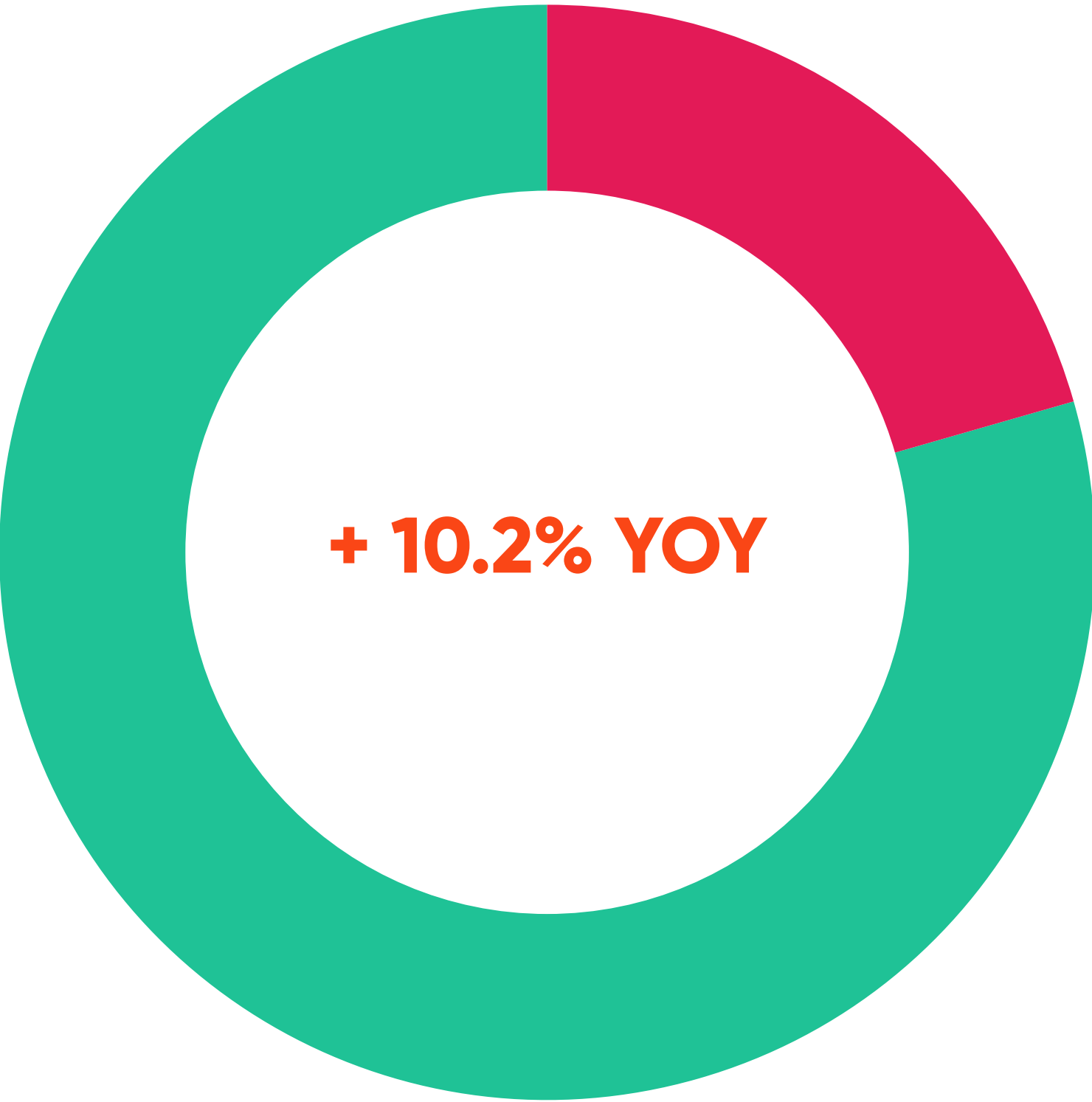
Source: ONS and IGD calculations, June 2023



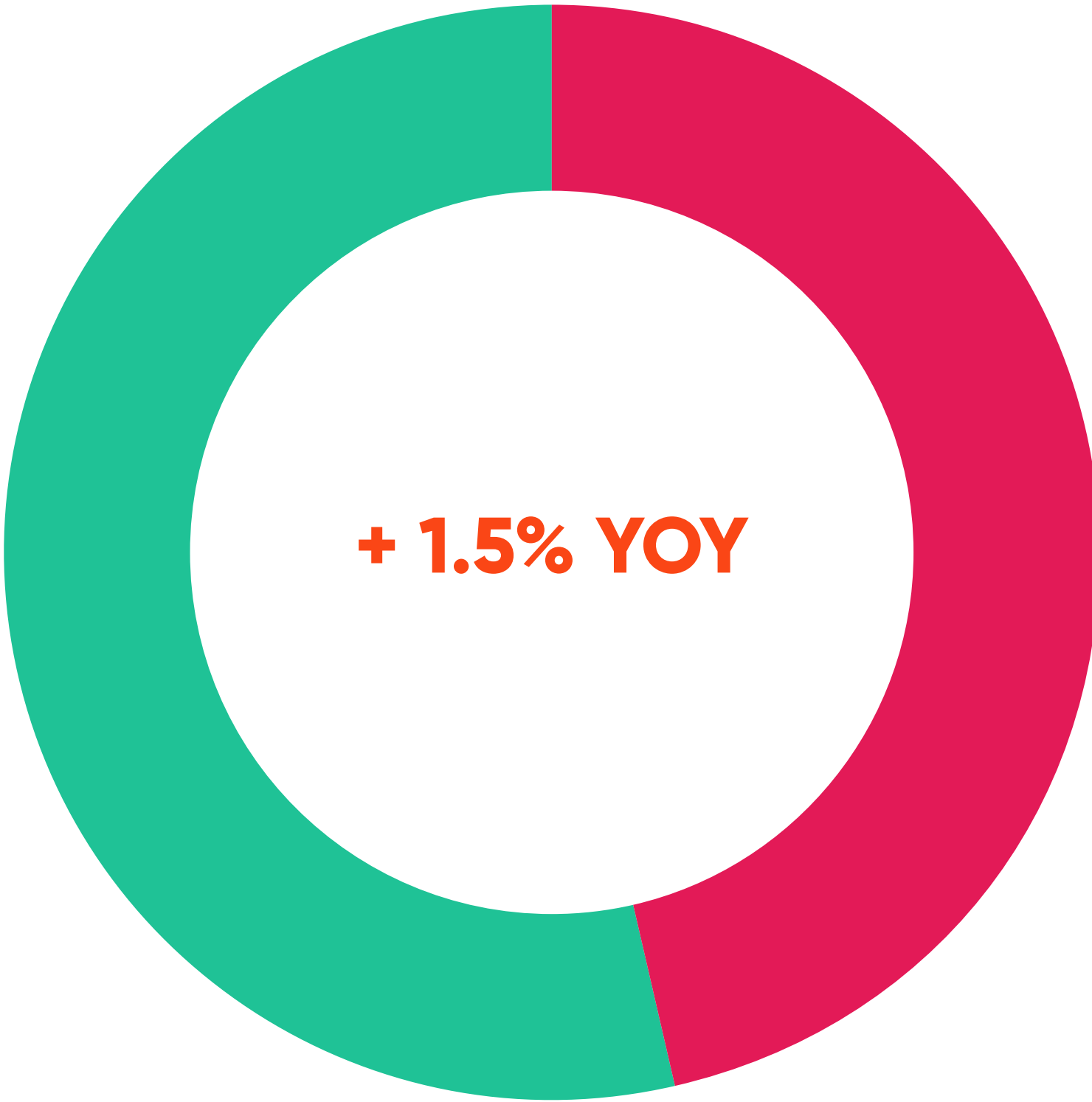
Data at a glance

Food price inflation as proportion of overall inflation

Source: Consumer Price Inflation, ONS , Economic & Fiscal Outlook, OBR and IGD calculations, June 2023



CPI, Q1 2023, actual



CPI, Q1 2024, estimate

Food & drink contribution to CPI:

- Q1 22: one tenth
- Q1 23: one fifth
- Q1 24: one half

Food, retail Other

Why is food inflation proving persistent?

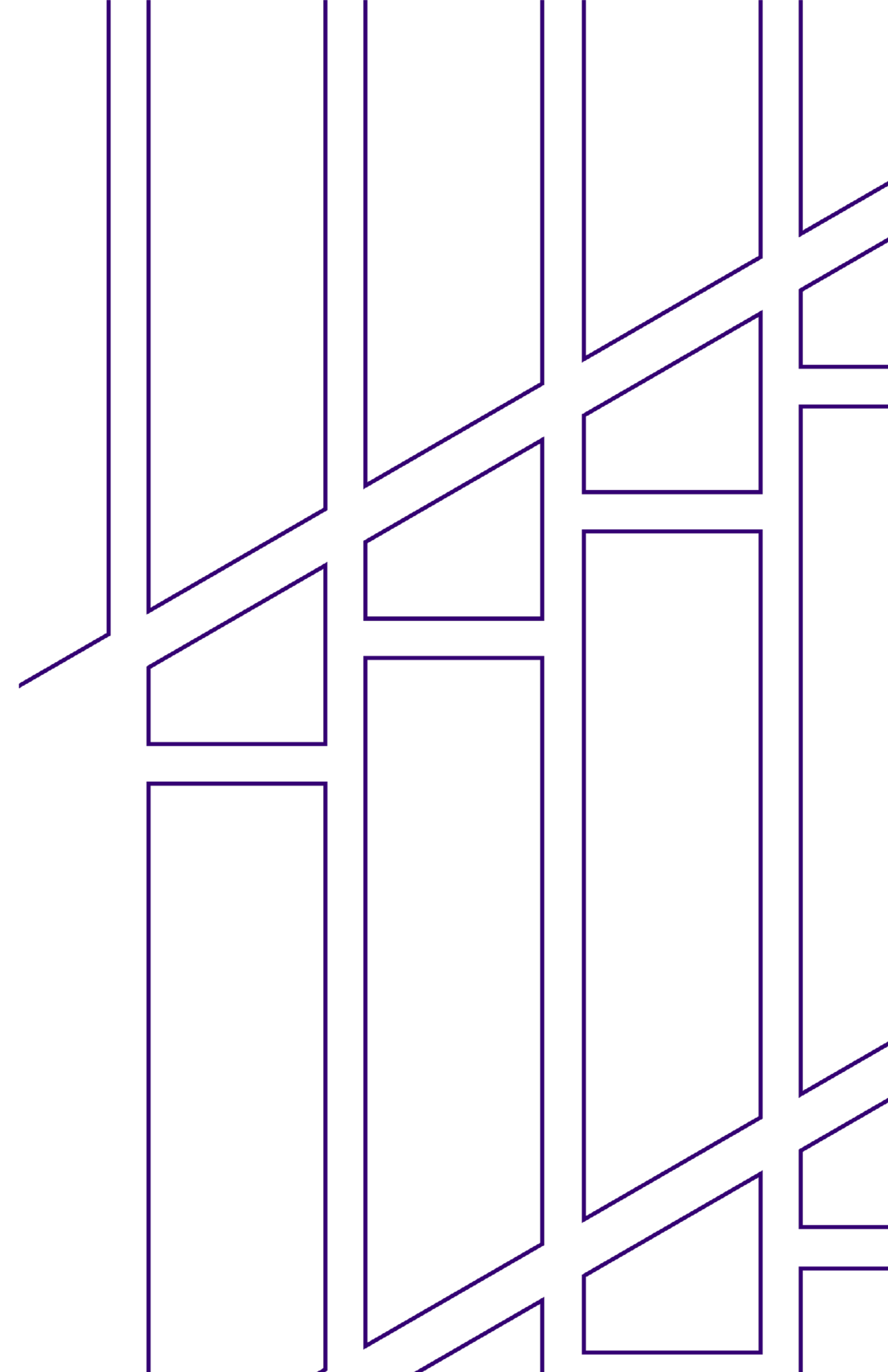


The good news is that that food price inflation has probably peaked and will begin to slow as 2023 progresses. The strong price increases of a year ago are now exiting annual comparisons. The powerful forces which drove those price increases may now be running out of momentum.

Prices for energy, fertiliser and some – not all – basic food commodities are falling. Food retail is highly competitive and businesses have a strong incentive to pass on the benefit of lower costs to shoppers.

However, the anticipated slowdown in food price increases is likely to be a slow process, running behind other essential items such as motor fuel and utilities. Factors contributing to this include long and complex supply chains, limited supply of natural resources, higher production and wholesale costs, and cost changes not yet being passed onto consumers.

Meat, fish, dairy, bread and cereals, which have been the largest contributors to the inflationary spike, will also see some of the longest declines as their cost changes still have significant time to be passed through.



What's happening?

The rate of slowdown of food price inflation will likely lag behind all items inflation. This will make food an outlier, creating reputational risk. The following factors are contributing to this:

- Long production cycles – Food and drink products can have long production cycles reliant on agricultural and industrial processes that often take a fixed time to complete. Different products will experience different production cycles, explaining why specific products are likely to see longer tails of inflation than others. For example, whilst the cost of producing milk has fallen slightly, costs for eggs remain very high.

- Supply chain arrangements – Food and drink supply chains are global, complex and long in their nature. It can take a significant length of time for price change at the top of the supply chain to be passed through to the consumer.

At this point last year, when food inflation was just 6%, producers at the top of supply chain saw unprecedented inflation in input costs:

- [Fertiliser prices](#) increased by 200% year-on-year
- [Natural gas prices](#) increased by over 360% year on year
- [Forward market prices](#) for wheat had increased by over 50%

The significant food inflation experienced over recent months, illustrates the length of time these price changes have taken to be passed through the supply chain, some of which are yet to be passed through fully.

Additionally, many food and drink products are traded using fixed and forward pricing arrangements. These agreements occur at all levels throughout the supply chain and are often corrected when contracts are renegotiated, slowing the price change along the supply chain.

Given the time it has taken for inflation to be passed through the supply chain, the same is true when deflation begins to occur at the top of the supply chain.

- Cost absorption – Previous cost changes have not yet been passed on down the supply chain in full. Businesses at every level, from farms right the way through to supermarkets, report absorbing cost change and enduring lower profitability.
- Limited natural resources – production of food and drink cannot always be increased readily in response to higher prices. Essential resources such as soil, water and labour are in limited supply. Some products can only be prepared at certain times of year and can take months or years before being ready for market.

Why it matters

This inflationary spike is likely to pass through the economy in phases. Initially input costs such as energy costs will drive prices up at the producer end, this then takes time to pass through the system.

If the inflationary spike is as severe as we have seen, falling margins throughout the system limits the ability for businesses to absorb costs now and later in the inflationary phase.

As employees see their cost-of-living rise, they are likely to continue to seek better wages, thus increasing costs of production, especially in labour intensive industries such as foodservice. This is driving a secondary phase of inflation.

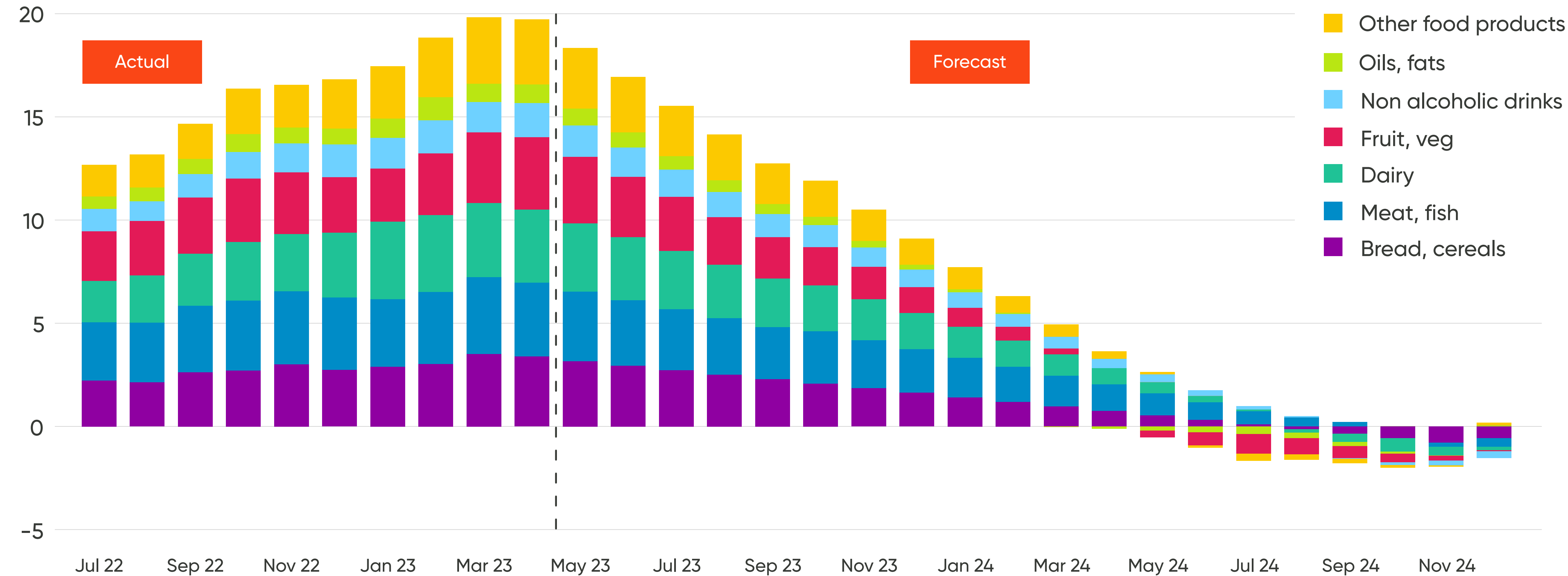
Additionally, a range of government policy relating to the food industry has the potential to increase costs for businesses in the near future. Given the margin compression across the system, any cost is likely to be passed straight onto consumers, further driving inflation.

Data at a glance

Food price inflation forecast by category

Year-on-year contribution to food and drink inflation (%)

Source: ONS and IGD estimates, June 2023



What will be the impact?



Our forecasts suggest there is and will continue to be a significant divergence between food price inflation and all items inflation.

In April 2023 food inflation was around double the level of general inflation across the economy. With energy prices [forecast](#) to fall further, there is significant risk food will be seen as an outlier and slow to bring prices under control.

IGD ShopperVista research suggests that trust over pricing has already slipped over recent months.

Falling consumer trust, as well as a challenging media and political landscape will generate significant reputational risk for many parts of the industry.

When food costs more, people tend to buy less. UK food retail has seen significant [volume losses](#) since the cost-of-living crisis began impacting UK households.

The food industry is intensively competitive. Pricing is transparent and consumers have many possible options.

This has meant that retail price change hasn't kept pace with cost increases, hitting food businesses profits.

Lower profits combined with falling volumes and higher interest rates may limit the ability of businesses to invest for the future.

What's happening?

The surge in inflation across the economy has eroded the value of wages and savings for the majority of households.

Household disposable income is forecast to have fallen by 7% by March 2024, the largest fall since records began.

This has had a significant impact on consumer behaviour. IGD ShopperVista data shows that:

- Price remains the most important factor for consumers when deciding what food and drink products they buy in supermarkets
- Three quarters of consumers expect food prices to get more expensive in the year ahead. This is the lowest level since July'21
- Three quarters of consumers say that the cost-of-living crisis has impacted their food and grocery shopping choices
- Top tactics employed by consumers to contend with rising food and grocery prices include buying cheaper brands or own label products, spending less on extras for themselves, making more things from scratch, buying in bulk more and buying less food



Why it matters

The most vulnerable households in the UK are more exposed than the average household to food price inflation as they spend a higher proportion of their household budget on food.

Affordability is a key component of food security. Whenever safe and nutritious food is not available at a price affordable to all, then the welfare of some people is jeopardised. IGD's ShopperVista research shows that some aspects of food insecurity have worsened over the last year:

- 41% plan to further reduce spend on food and grocery shopping in the next few months (April 2023), rising to 48% of those on the lowest incomes
- 24% are eating lower quality food and grocery products e.g. cheaper cuts of meat (April'23 vs 18% Apr'22), rising to 33% on the lowest incomes
- 41% are switching to cheaper options at supermarkets e.g. value private label ranges (April'23 vs 29% Apr'22) rising to 48% on the lowest incomes
- 17% are missing more meals or snacks (April'23 vs 11% Apr'22) rising to 27% on the lowest incomes
- 8% say they will use a food bank in the next few months, rising to 17% of those on the lowest incomes (Apr'23)

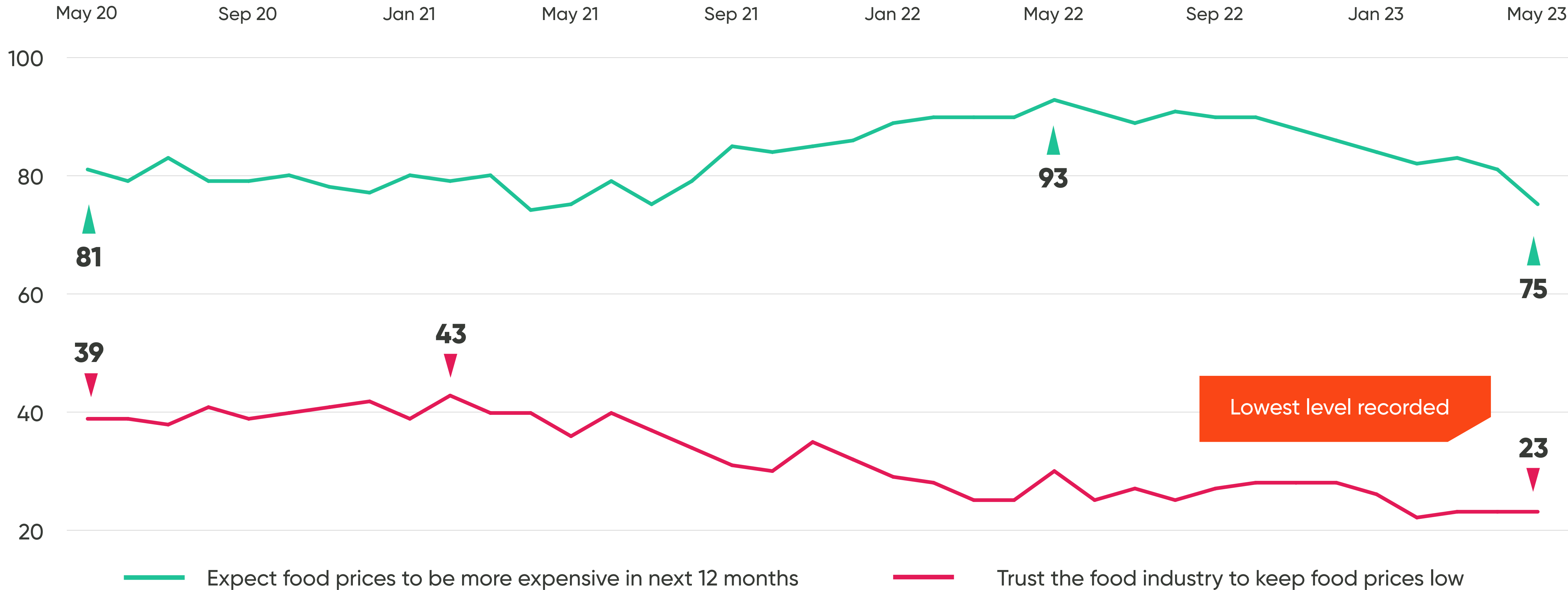


Data at a glance

Perceptions of food prices

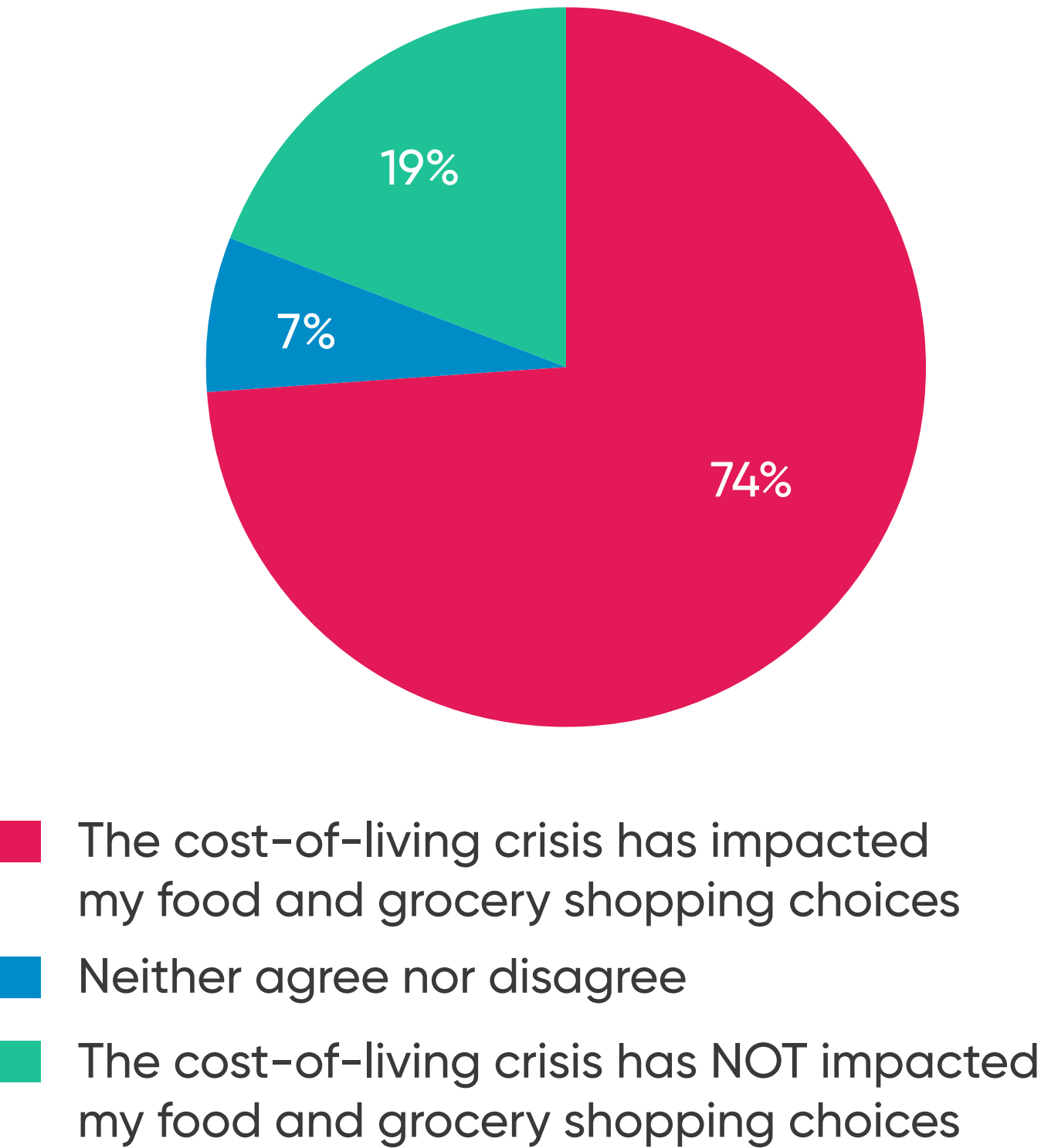
Share of respondents (%)

Source: ShopperVista, IGD Research, May 2023
Base: >1,000 GB shoppers per wave, balanced sample



Data at a glance

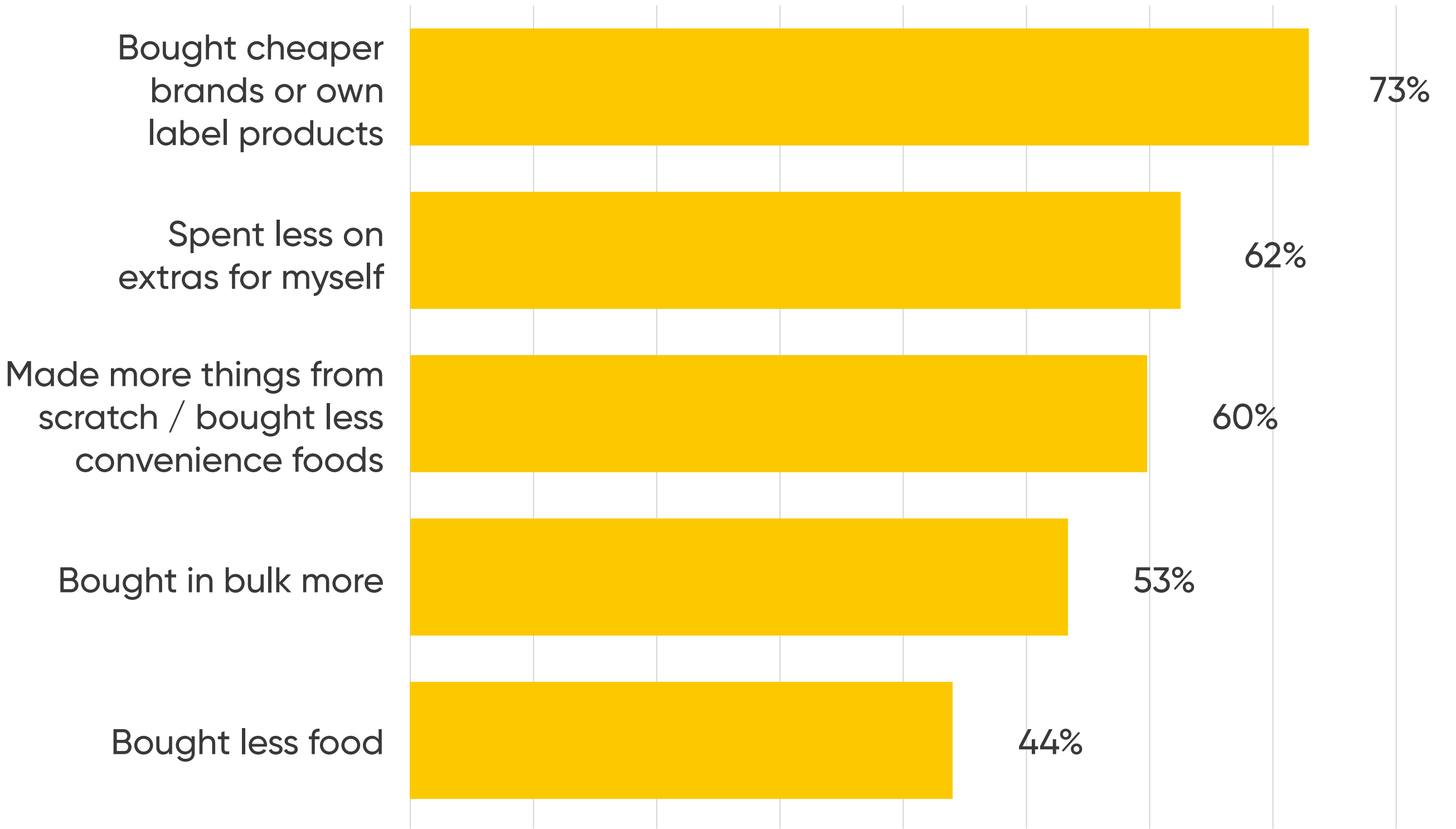
Changes in shopping choices



Source: IGD Research, May 2023, Base: 997 GB shoppers, balanced sample

Changes in shopping choices

% making changes to food and grocery shopping in last few months



Implications for your business

Support low income households

Take practical steps to help low-income households suffering particular financial stress. Options include offering a wide range of nutritionally sound but low priced products, offering advice to those working on a fixed budget and donating food to charities and food banks

Higher interest rates

The Bank of England recently increased interest rates to 4.5%, the highest level for almost 15 years. Allow for a significant impact on the spending power of those with mortgages and those who rent.

Identify ways to reduce costs

Identify and resolve the root causes of food waste along the supply chain. Adopt cost saving technologies. Map activities across supply chains to identify opportunities to reduce complexity and reduce costs.

Be transparent

Be open and transparent about any trade-offs made, for instance if you change the size or recipe of a product. Maintain an open and frank dialogue with consumers and other interested parties, discussing the issues and options



Next steps

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