

## FOCUSING ON FOOD

A recent report from the World Bank reminded investors that global food prices rose 83% in the past three years. Food is obviously a crucial component of the overall consumer goods basket and as such, a key inflation item. This week's Marker reviews the evidence and potential consequences of the run up in food prices.

### GROWTH PAINS FOR THE WORLD

Given the recent economic slowdown in the U.S. it is easy to forget that the four years ended in 2007 produced some of the strongest economic growth in the past forty. Furthermore, this growth was the most diversified ever with emerging countries - led by China but broadly dispersed - finally getting a large share of the increase in activity and wealth. One cannot ignore the irony of the fact that this very increase in living standards is one of the main causes of food price increases as millions were finally able to move beyond the ranks of the destitute by improving their diets. Yet, this new demand has created a challenge the farmers of the world are having great difficulty meeting. Rocketing prices for many food staples are having very real impacts on entire countries and regions. For example, rice is a key food staple for nearly half of the world's population, and its price has doubled in the past three months. For many emerging countries, food represents 50 to 75% of the population's budget. Countries like Senegal and Haiti import 80% of the rice consumed. Food riots in Haiti were a strong contributing factor to the recent ouster of the President, and we should not forget that demonstrations against high food prices were part of the events leading to the Tiananmen Square massacre in 1989.

### Percentage of total expenditures in food per country (114)

Country	Total Expenditures (%)
India	45.00
Russia	34.35
China	33.00
Brazil	22.71
Canada	11.68
<b>Average</b>	<b>29.35</b>

Sources: NBF and Natcan

### SUPPLY AND DEMAND CONSPIRE

The case for strong demand for food staples is clear. The main cause of a lack of supply illustrates how interconnected the world has become. Indeed, six long years of drought in Australia, the world's number-two exporter of rice behind Thailand, explain a good share of the current shortage. Australia's output has fallen 98% since the start of the drought. The Deniliquin mill, the largest rice mill in the Southern Hemisphere, used to process enough rice to feed 20 million people, but it had to be mothballed in December 2007 because of a lack of water. Large consuming countries are reacting by implementing measures that range from export bans to special multilateral trade deals. One more point needs some clarification. Politicians have pointed the finger to mandated ethanol production as a culprit for global food price increases. We need to keep in mind that ethanol is produced from corn and while this clearly leads to some production displacement, the second-order effects are nowhere near what the headlines would suggest for the time being. It is true that ethanol is the one area of agriculture production about which immediate action can be taken, but the rhetoric must be placed in context.

In the developed world, food price increases have impacts that go beyond the risk of famine: they play a key role in setting inflation expectations for consumers. Food inflation has risen 5% in the U.S. over the past year, and over 90% of China's inflation is explained by food prices. While the Federal Reserve insists on the fact that current inflation increases may be transient, we need to closely monitor wage trends for signs of further firm demands for compensation increases destined to alleviate pressure from a higher cost of living.

## NATCAN WEEKLY MARKER

Food prices are up significantly around the world. Investors need to factor this in their decision making on at least two levels: by realizing that futures prices for food staples are likely to exhibit high volatility going forward, and by paying close attention to global inflation statistics, which are at real risk of moving to a higher plane entirely with very significant impacts on the cost structures of entire economies.

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## FINANCIAL MARKETS

RETURNS AS AT APRIL 18, 2008 (%)	MTD	QTD	YTD	RATES AS AT APRIL 18, 2008	
S&P/TSX	6.71	6.71	3.68	CAD/USD	1.01
S&P 500	3.00	3.00	-3.67	CAD/Euro	1.59
S&P/TSX Small Cap	4.57	4.57	0.33	US Treasuries yield 10-yr/30-yr	3.75/4.52
Russell 2000	2.66	2.66	-4.47	GOC bond yield 10-yr/30-yr	3.69/4.14
MSCI EAFE	2.51	2.51	-2.92	Fed Fund Rate (target)	2.25
MSCI World	3.27	3.27	-2.36		
DEX Universe Bond	-1.55	-1.55	1.36		

Note: Returns in Canadian dollars, London 4h exchange rates. Source: Datastream, PC Bond, MSCI-Barra, and Bloomberg. PC-Bond, a business unit of TSX Inc. Copyright © TSX Inc. All rights reserved.

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