THE WALL STREET JOURNAL.
WSJ.com

BUSINESS | FEBRUARY 25, 2011

Consumers Start to Feel Pinch From Higher Grain Prices

By SCOTT KILMAN And JULIE JARGON

The surge in grain prices that has been stoking food inflation for months in much of the world is beginning to seep into U.S. supermarkets and restaurants.

U.S. food prices will jump between 3% and 4% this year, the U.S. Agriculture Department forecast Thursday, after rising in 2010 by the slowest rate since 1962.

The cost of processing food is soaring in part because foreign demand for U.S. agricultural commodities is surging at the same time the rising price of gasoline is stimulating the biofuel industry's appetite for corn to make ethanol.

Prices of corn, wheat and soybeans—crops that are ubiquitous in U.S. food products—are up 88%, 76% and 37%, respectively, from 12 months ago. The soaring cost of fattening livestock with grain is also helping to lift prices of hogs and cattle to record-high levels. On top of all that, rising oil prices are lifting costs of packaging and transportation.

The USDA raised its 2011 food-inflation forecast Thursday from the 2% to 3% range it had been projecting since July. The government's consumer-price index for all food rose 0.8% in 2010. A change of one percentage point in the food-inflation rate is equal to about $12 billion in annual spending.

The USDA expects food prices this year to climb at roughly twice the general inflation rate. But U.S. consumers are insulated from the full brunt of the price spirals under way in many emerging and developing economies, where raw commodities represent a bigger share of food costs, and people spend a far bigger proportion of their incomes on food than do U.S. consumers. In India, where tens of thousands of people protested high food prices this week, food prices have been climbing at double-digit rates.

In the U.S., supermarket executives remain leery of hitting consumers with much higher costs for fear they will shop elsewhere. The stubbornly high unemployment rate is still casting a shadow over many consumers, who are pinching pennies despite the recession's end.

"Right now, it is trench warfare between food companies that want to raise prices and supermarkets, which don't," said Michael Swanson, an economist at Wells Fargo & Co., who thinks retail food prices will climb between 4% and 4.5% this year, and perhaps higher.

"We're taking a lot on the chin," said Sara Lee Corp. Chief Executive Marcel Smits at a recent conference for consumer-goods investors. His company expects to face $550 million in higher commodity costs this fiscal year compared with the prior year, as prices for coffee and other goods continue to rise.

Kraft Foods Inc. recently said its commodity costs in North America could climb between $700 million and $800 million in 2011 from last year.

Even Starbucks Corp., which lately has seen both customer visits and the average price customers pay for drinks increase, is hesitant to recover its skyrocketing coffee costs with across-the-board price increases, preferring instead to raise prices only on certain products in certain markets.

"With the economy and the pressure people are under, I just don't think that's the right thing to do at this time," said Howard Schultz, Starbucks chief executive officer, in a recent interview.

Texas Roadhouse Inc., a 345-unit steak chain based in Louisville, Ky., on Tuesday said it would raise menu prices by 1%, even though it expects its food costs to rise by 3% this year.

Some meatpackers seem to be having the most success pushing along their higher costs, in part because per capita supplies of beef and pork are shrinking, which gives them some pricing power. Retail beef prices in January were 9.7% higher than in January 2010 while retail pork prices were 9.9% higher.

—Ilan Brat contributed to this article.