USDA Foreign Agricultural Service
GAIN Report
Global Agricultural Information Network

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Voluntary - Public

Date: 4/27/2011
GAIN Report Number: CH11602

China - Peoples Republic of

Post: Guangzhou

ATO Guangzhou Pre-2011 Spring Festival Staple Goods Food Inflation Report

Report Categories:
Market Development Reports

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Report Highlights:

General Information:

With relentless growth in China's GDP comes uncompromising food inflation. Though China's currency is artificially priced low to support an export-dependent Guangdong Province economy, according to central government analysts, it is excess liquidity in the market that is responsible for driving inflation. Inflation has forced Beijing to cool off real estate investment, tighten low-interest loans, and even raise the value of the RMB currency. In fact, since June 2010, the value of the RMB has increased 3.6 percent. Many mills/crushing plants in South China welcome these new policies because by removing the amount of excess capital, it will hopefully correct bloated wheat and soybean prices and reduce the role market speculation plays in the market. Most mills should have the ability to hold wheat flour prices without significantly losses for the next two quarters of 2011. Some reports have food inflation nearing 12 percent; with speculative trading and hoarding being singled out as inflationary culprits. The central government has adopted serious measures against price speculation on staple goods and other agricultural commodities. Once convicted, the penalty could be as high as 5 million RMB (or $763,400). Below is a rudimentary analysis of China's staple goods:

Pork: In Guangzhou, the average live pig wholesale price is $1.05 USD per pound (or 15RMB per kilogram, $1USD=6.55RMB) a nine-percent increase from the previous year. In the retail sector, deboned lean pork meat is sold at $2.23 per pound (or 32RMB per kilogram), 13-percent higher than last year. However, these prices are not as high as those in 2008 when live pigs and lean meat were sold at 18 and 35RMB per kilogram respectively. Since the fourth quarter of 2010, pork prices have been appreciating mainly because of increased feed costs and market demand prior to the Chinese New Year (in early February 2011). In Q2 of 2011, pork prices might be impacted by feed costs, gasoline prices, and animal disease outbreaks. In Q3, Guangdong Province's anticipated 19-percent minimum wage increase will be the main driver for all food price increases. The impact will be immediately felt by consumers.

Edible oil: Edible oil is sold at a retail price of $2.3-3.06 (or RMB15-20) per liter. Since October 2010, oil prices have increased by 10-15 percent. Finally in November, the National Development Reform Commission (NDRC) mandated price control policies to moderate the threat of inflationary pressures. If soybean prices keep climbing at this pace, edible oil prices will soon follow suit. Unless the NDRC decides to tighten the lid on prices throughout Q2 and Q3, edible oil prices will drive up soybean meal prices and inevitably impact livestock sector operations. 2011 Q2 Producer Price Index projections are already anticipating the threat of higher soybean meal prices.

Rice: Rice is the main grain grown and consumed in South China. Due to unfavorable weather conditions in 2010, the rice harvest was marginally affected; however, the market's reaction was not proportional to the actual severity of the freeze's damage. From November 2010 to January 2011, rice retail prices increased by almost 50 percent; with the average retail price is now $0.42 per pound (or RMB5 per kilogram). In November 2010, in anticipation of stronger prices, some farmers were reluctant to market their harvests creating a lag that contributed to the price appreciation. Government's response was to flood the market with reserve grains to signal sufficient supplies were available, deflate prices creating disincentives to hoarders, and mitigate fears of shortages in the supply chain. In South China's Pearl River Delta, the general public doses not worry about tight rice supplies since imported rice, mainly from Thailand, is also marketed at relatively stable prices and in good supply.

Conclusions: There is significant correlation between the food inflation issues and the migrant labor problem. Rural areas feel the pinch of higher food price much stronger than cities. Any time prices increase, supplies move faster towards cities that can afford better prices. During certain times prices for staple goods nearly doubled of what they were only a year ago, especially in some mid-sized cities. Rural areas are devoid of price control policies that primarily protect urban residents. Since cities are outbidding consumers in rural areas, rural residents find themselves priced out of certain markets during periods of strong consumer demand. It's anyone guess how authorities will balance the competing interests of consumers and producers.