The Food Foundation

BRIEFING

Food prices and profits during the cost-of-living crisis

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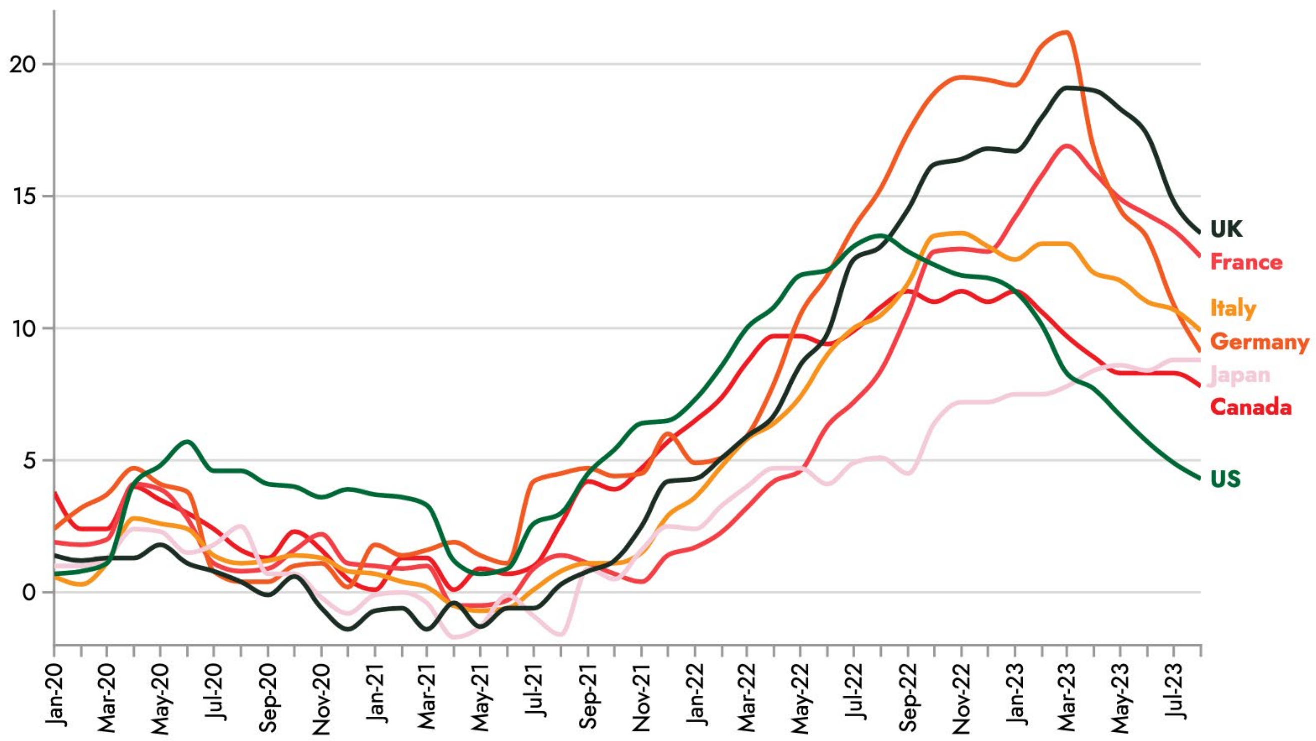
BACKGROUND

The annual rate of UK food price inflation increased to 19.1% in the 12 months to April 2023 – the largest rise for over 40 years.[1] This was triggered by a number of factors including: energy prices soaring due to a rapid post-pandemic rebound in demand; the Russian invasion of Ukraine and the resulting impact on European energy prices and the global supply of food commodities such as vegetable oils, wheat and fertilisers; labour shortages which left some crops unharvested; a major avian influenza outbreak in the UK; and extreme weather in Europe and North Africa. All of these have led to higher food prices.[2]

Although food price inflation has now slowed to 13.6%, compared to 19.1% in April, it remains much higher than overall inflation which was at 8.7% in April and 6.7% in August. Energy prices are also falling, and although food price inflation is thought to have peaked, food is now the biggest overall contributor to inflation in the UK and is predicted to contribute to 47% of overall inflation by Q1 2024 (compared to 21% in Q1 2023).[3]

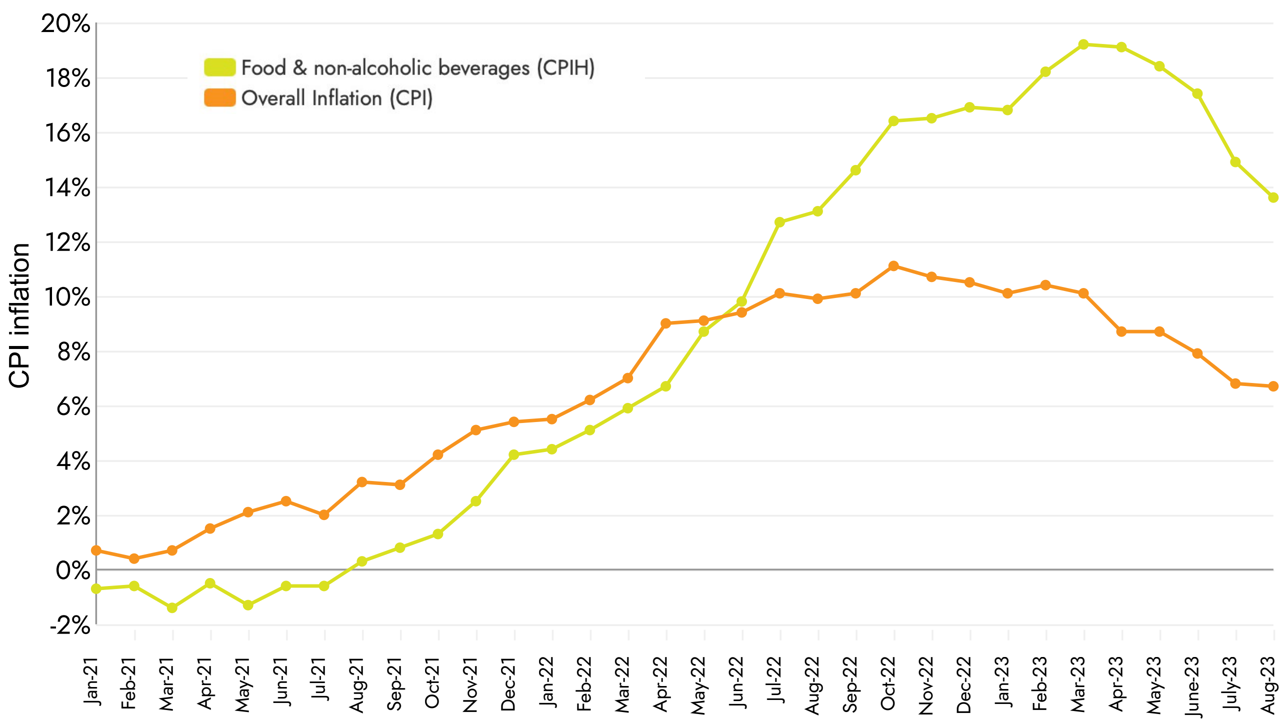
Despite inflation rates rising globally since 2021, levels have been higher in the UK compared to some other European countries, with UK food price inflation among the highest across G7 economies in March 2023 (figure 1). Germany had the highest rate of food price inflation in March (21.2%) but this has rapidly slowed in the months since (9.1% in August), meaning the UK is now the highest with inflation at 13.6% in August.[4,2] Higher UK inflation rates can be partially attributed to the impact of Brexit – research by the London School of Economics found that almost a third of food price inflation since 2019 was due to Brexit, and additional costs at the border have added £7bn to food bills (equivalent to £250 per family).[5]

FIGURE 1: UK FOOD PRICE INFLATION ACROSS THE G7 ECONOMIES (Source: Organisation for Economic Co-operation and Development (OECD), the Office for National Statistics (2023) and Trading Economics.)



Households are facing the highest rates of food price inflation since the 1970s, with low-income families disproportionately affected as they spend a far greater share of their family budgets on food (14% – compared to 9% for the highest-income households – according to the Resolution Foundation).[6] As a result, the inflation rate for the poorest tenth of households is around 2 percentage points higher than it is for the richest tenth of households.[6] The Resolution Foundation estimates that annual food bills for the average family are now £1,000 higher than their pre-pandemic level.[6] This has led to higher rates of food insecurity increasing the risk of negative long-term health outcomes for many.

FIGURE 2: FOOD PRICE INFLATION HAS BEEN OUTPACING GENERAL INFLATION IN THE UK (Source: The Food Foundation, Food Price Tracker)

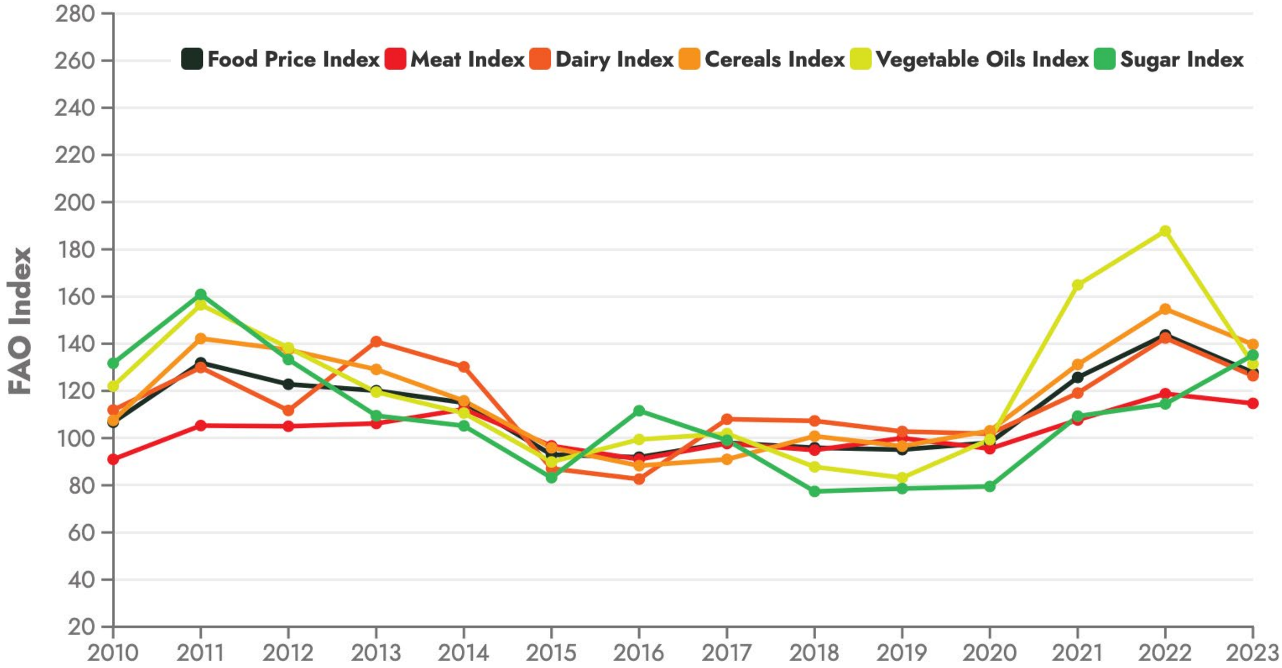


Global food commodity prices, although still 33% higher than pre-pandemic levels, have been falling since mid-2022 (figure 3). However, this fall in global commodity prices has not yet filtered through to UK retail prices.[2]

The Office for National Statistics suggests several possible explanations for this[2]:

- Transmission lags between farmers and retailers mean price changes take a while to filter through the value chain e.g., suppliers tied into long-term contracts for inputs (such as fertiliser and energy supply) at fixed prices are less able to change their prices at speed.
- The UK is heavily reliant on imports and the price of imported food products has been rising at twice the rate of domestic food. Countries like Italy and Spain which produce more of their own food have seen lower food price increases.
- Profit margins are being rebuilt as companies look to offset previous shocks and previous margin compression.

FIGURE 3: ANNUAL GLOBAL PRICES OF FOOD COMMODITIES, 2010–2023 (Source: The FAO).



The FAO Food Price Index (FFPI) is a measure of the monthly change in international prices of a basket of food commodities. It consists of the average of five commodity group price indices weighted by the average export shares of each of the groups over 2014-2016.[7]

A GROWING 'GREEDFLATION' NARRATIVE IN THE UK

There have been increasing reports of 'greedflation' or 'profiteering' in the UK – in the media, by trade unions, and by some economists. This is the idea that food businesses are driving inflation by raising prices above their costs to make excess profits whilst families struggle to afford everyday essential costs. Although overall inflation peaked in October 2022, food price inflation does not appear to have peaked until March 2023 (figure 2) and this time lag contributed to concerns that food price inflation may be persisting due to weak competition in the food supply chain.[8]

In March, the EFRA committee raised concerns that supermarkets could be making excess profits and appealed to Environment Secretary Thérèse Coffey to request data from food supply chain businesses using Agriculture Act 2020 powers.

It opened a Supply Chain Fairness Inquiry to investigate how profitability and risks are shared through the food supply chain and the existing government system of monitoring and regulation. In June, Senior Executives from four of the major retailers rejected accusations of excess profit making during questioning by MPs over the rising cost of groceries.

With opinions divided, and a significant lack of detailed data or clear evidence on corporate profits and supply chains on either side, the Competition and Markets Authority (CMA) announced new work looking at the drivers of groceries price inflation, the relationship between changes in input prices and changes in consumer prices, and the effectiveness of competition in any part of the supply chain. The results of this investigation are detailed below.

CURRENT AVAILABLE EVIDENCE

On 20 July the CMA issued a report effectively clearing the supermarkets of any profiteering accusations. The investigation found that despite food price inflation rising to historically high levels, the evidence suggested this was not due to competition issues.[8]

It pointed to the fact that operating profits (the money left after paying all business costs, but before paying tax) in the retail grocery sector fell by 41.5% in 2022/23, compared with the previous year, while average operating margins fell from 3.2% to 1.8%. This was down to retailers' costs (particularly goods, labour and energy) increasing faster than their revenues, indicating rising costs have not been passed on in full to consumers. They also examined the operating margins (revenues less the costs attributable to the point-of-sale e.g., costs of the goods sold, warehouse and transportation costs) of the major supermarkets (Tesco, Sainsbury's and Morrisons). They found that in the financial year 2022/23 operating margins fell, albeit stayed broadly in line with average margins for the last five years.

The report also found that consumers were continuing to switch to the discounters to find lower prices (both Aldi and Lidl have gained market share), suggesting supermarkets were unable to keep prices artificially high without losing business. However, it recognised that not everyone can easily benefit from strong competition, particularly those who live in food deserts and usually have to rely on higher-priced convenience stores.

Despite their conclusions on groceries, the CMA's separate road fuel market study concluded that higher fuel prices were at least partly due to a weakening of competition in the road fuel retail market. Average annual supermarket margins on fuel increased by 6p per litre between 2019 and 2022, with at least one supermarket having significantly increased its internal forward-looking margin targets over this period and other supermarkets adjusting their pricing behaviour accordingly.

Overall, the CMA concluded, competition in the retail grocery sector is working better than in the energy sector. However, uncertainty remains over whether weak competition in other parts of the groceries supply chain, or in specific product categories, could be contributing to food price inflation. The next phase of the CMA investigation, to be reported on in Autumn, will examine competition across the supermarket supply chain and focus on a raft of key product lines to gain a deeper understanding of price and competition dynamics across the supply chain and ensure competition is working properly on behalf of consumers.

Meanwhile, a separate review into unit pricing by the CMA found that pricing could be making it difficult for people to spot the best deals due to retailers using inconsistent measurements to unit-price comparable products within their stores and online. It has set out recommendations to the government to reform and improve unit pricing legislation.

WHAT WE DID:

For this briefing, we conducted our own investigations. Although some reports have used net profits and net margins as the basis of profiteering accusations, net income figures are too simplistic and not an accurate representation of profit or profit margin increases. Instead, we looked at ONS Producer Price Index (PPI) and Consumer Price Index (CPI) data. PPI data tracks the changes in the prices of goods bought and sold by UK manufacturers, including price indices of materials and fuels purchased (input prices) and factory gate prices (output prices). CPI data shows the rate at which the prices of goods and services bought by households rise or fall with inflation.

Figure 4 compares PPI and CPI percentage annual output inflation rates from January 2022 to August 2023. This shows the fluctuation in price trends paid by retailers to food producers, in comparison to the prices paid by consumers to retailers.

FIGURE 4: OUTPUT PRICES - ANNUAL INFLATION RATE (%) (Source: Office for National Statistics)

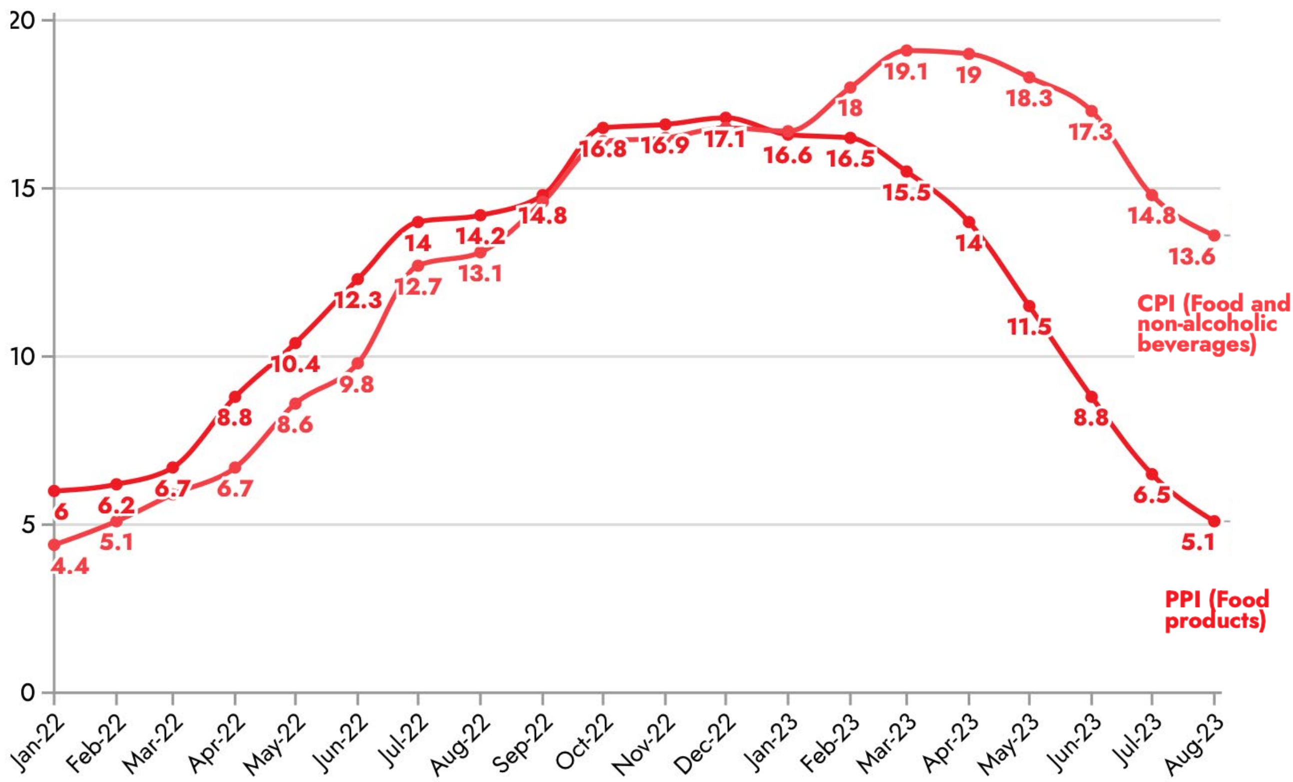


FIGURE 5: INPUT PRICES, INDEX VALUES, INFLATION RATES AND PERCENTAGE POINT CHANGE TO THE ANNUAL INFLATION RATE. UK, AUGUST 2022 TO AUGUST 2023 (Source: Producer Price Index (PPI) from the Office for National Statistics)

		PPI Index (2015=100)	Monthly rate	Annual rate	Change in the annual rate (percentage points)
2022	**Aug**	151.3	-0.6	21.3	-1.4
	Sep	152.8	1.0	21.2	-0.1
	Oct	154.2	0.9	20.0	-1.2
	Nov	153.8	-0.3	17.6	-2.4
	Dec	152.0	-1.1	16.1	-1.5
2023	**Jan**	152.7	0.4	14.6	-1.5
	Feb	151.9	-0.5	12.3	-2.3
	Mar	152.2	0.2	7.0	-5.3
	Apr	151.8	-0.3	3.8	-3.2
	May	149.7	-1.3	0.3	-3.5
	Jun	147.9	-1.2	-2.8	-3.1
	Jul	147.3	-0.4	-3.2	-0.4
	Aug	147.9	0.4	-2.3	0.9

ANALYSIS:

Figure 4 shows inflationary rises across the supply chain over the course of 2022, with both producers and consumers paying higher prices. However, there is a significant time lag between PPI rates declining and CPI starting to reduce. Although PPI rates seemed to peak in December 2022 and then began to decrease from January, CPI rates dipped only slightly to 16.7% in January, then jumped up again to 18% in February, further still to 19.1% March and did not start declining till April. Although the rate of output producer price inflation for food is now slowing, we are yet to see a notable drop in consumer price inflation for food.

Time lags are a common feature of the food supply chain.[8] Similar transmission lags can be seen in the previously discussed delay between changes in global food commodity prices (figure 3) and UK retail prices (figure 2), as well as the lag between the peak of CPI annual inflation (in October 2022) and food price inflation (March 2023), as shown in figure 2.

The CMA suggest that time lags can be explained by long term, fixed price contracts that producers are locked into. This means that despite input inflation rates slowing (the price of materials and fuels bought by UK manufacturers for processing, see figure 5 – the annual input prices for both home-produced and imported food products fell significantly from May to June), there will be a time lag before this starts to flow through the supply chain and is reflected in the CPI data as producers can't sell at lower prices until their contracts end. In the coming months, as these contracts come to completion, the reversal of food price inflation as shown in the PPI data should be reflected more clearly in retailer consumer prices. Labour is a major cost for retailers, and as labour costs for all sectors rose over this period (a major inflation driver) this could also be a reason for the retailers delaying price reductions even as PPI rates come down.[23]

There is no clear evidence, so far, to point to profiteering among retailers during the cost-of-living crisis. However, some supermarkets have indicated they will be looking to rebuild their operating profit margins over the coming months (though this might be difficult to do without losing market share).[8] It is important that the CMA continues to monitor the situation so that consumers benefit from slowing inflation rates and can be confident retail competition issues are not contributing to the persistence of groceries price inflation.

WHAT IS BEING DONE IN OTHER COUNTRIES:

- In March, the French government pushed large retailers to freeze prices on some products from March until June to create an 'anti-inflation quarter'.[9] This appears to have had an effect, with the rate of food inflation slowing from 15.9% in March to 13.7% in June.[10] The French government have continued to exert pressure on food businesses with 75 large food manufacturers pledging to lower prices on hundreds of products from July.[11]
- States hit hardest by rising prices, such as Croatia and Hungary, capped the cost of essential food items from 2022.[12] Hungary's government also ordered retailers to make bigger mandatory 10% price cuts for certain food products, and with food price inflation still at 22% in July, this was increased to 15% from August.[13]
- Spain, Portugal and Italy have cut sales taxes on food products to ease the burden on shoppers.[14] As most food in the UK is exempt from VAT, this is not something the UK government could replicate.
- Greece has taken an alternative approach to limit prices by capping retailers' profit margins on food and other essentials.[12]
- A World Bank report, published in May, called on EU governments to provide more "targeted policy interventions and social safety nets" to support those suffering from the cost-of-living crisis.

A TIMELINE OF FOOD SYSTEM TURBULENCE:

2019

- In October, agreement was reached on the UK's EU withdrawal deal following intensive negotiations between the European Commission and UK negotiators. The UK's Brexit withdrawal deal is extended until 31 January 2020 to allow more time for the agreement to be ratified.
- Four supermarket chains – Tesco, Sainsbury's, Morrisons and Asda – dominate UK food retailing, accounting for 70% of the market.[7] The discounters, Aldi and Lidl, continue to gain market share.

2020

- March 23rd: Nationwide lockdown begins with the closure of the out of home sector including restaurants, cafes and office canteens. There are reduced restrictions between June and September.
- November: second national lockdown. The out of home sector closes again.
- **Impact on retailers:** Unusually high net profits were reported by most retailers and retailers' share of the groceries market increased.

2021

- January to March: third national lockdown. All restrictions lifted by July.
- July: Global food price inflation and some food shortages due to a combination of factors including; fuel and CO2 shortages as a result of a rapid rebound in demand after lows during the pandemic; labour shortages; climate related disruption to harvests.[15]
- Out of home sector slowly recovering market share but significantly down on pre-pandemic.

2022

- February: Russian invasion of Ukraine, driving up food prices due to the impact on Ukrainian and Russian food and fuel exports, which in turn increases the cost of inputs such as animal feed, fertiliser and fuel.
- UK drought during the summer months and labour shortages contribute to milk price increases.
- Egg shortages due to avian flu outbreak. General food inflation increases throughout 2022, with the price of certain food products particularly impacted, including sunflower oil, milk, eggs, chopped tomatoes and cucumbers.[16]

2023

- April: the price of a weekly basket of food has increased by 24–26% since April 2022.[16]
- May: Inflation is thought to have peaked. Food inflation hits 19.1%.
- ONS reports that around 4 in 10 adults (44%) say they are spending less on food shopping and essentials, and half (50%) of adults said they were buying less when shopping for food.[17]
- August: Food inflation has decreased to 13.6% from 14.9% in July, however food prices are expected to remain high.

RECOMMENDATIONS FOR SUPPORTING UK HOUSEHOLDS THROUGH THE COST-OF-LIVING CRISIS.

Food price inflation is thought to have peaked but is expected to stay at high levels till well into 2024, and there is unlikely to be a material fall in food prices overall.[8] Food prices also remain vulnerable to the effects of geopolitics and climate change; the extreme temperatures in southern Europe this summer, for example, as well as Russia pulling out of the Black Sea Grain deal. Events like this mean there is a further danger of food price volatility.

With 9 million adults (17% of households) having experienced food poverty in June, there is more that can and ought to be done by both Government and businesses to urgently support UK households through the cost-of-living crisis.[18]

WHAT SUPERMARKETS SHOULD BE DOING:

- **Support the Kid's Food Guarantee.** The Food Foundation's Kid's Food Guarantee offers retailers an alternative to price caps, outlining a set of actions that ought to be in place as a minimum to protect households with children from the cost-of-living crisis. Suggested actions include running price and volume promotions on staple carbohydrates and other healthy essentials where such multibuy or dicounted deals are offerred, insulating the cost of first infant milk formula from the worst of food price inflation, ensuring that the cheapest product in key kids' categories, such as yogurt and cereal, is also the healthiest, and offering budget ranges in both small and large stores.
- **Pay the Living Wage.** No UK retailer is currently National Living Wage accredited. Although most supermarkets have increased wages in recent years, the pay gap between executive level pay and shopfloor worker base pay remains high, with a quarter (25.8%) of food sector workers experiencing food insecurity in January 2023.[19,20]

WHAT GOVERNMENT SHOULD BE DOING:

SHORT TERM:

- **Continue to closely monitor grocery prices** to ensure customers benefit from slowing inflation, as retailers may look to recoup profit margins.
- **Increase minimum wage and benefits in line with inflation,** and factor in the cost of affording a healthy diet to benefit levels.
- **Expand existing nutritional safety net schemes** to ensure that low-income households are able to afford and access nutritious food. Specifically, the Healthy Start and Free School Meal schemes ought to be expanded to all families in receipt of Universal Credit.

LONG TERM:

- **Produce a strategy for improving the resilience of UK food security** by increasing the home-grown supply of food, particularly fruit and vegetables, and reduce the UK's heavy reliance on imports. The price of imported food materials has been rising at twice the rate of domestic food with countries like Italy and Spain that produce a larger proportion of their food experiencing lower price increases.[2] The BRC and the food and logistics industry have warned the government that Britain's dependence on European food imports is a risk, given that the incoming round of post-Brexit border controls set to be introduced in January could reverse the trend of decreasing inflation and may cause supply-chain disruption.[21] With a considerable proportion of fruit and vegetables consumed in the UK being imported from countries vulnerable to water stress or the effects of climate change, building a greater domestic supply of fruit and vegetables is vital to future food security.[22]

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