When food becomes political.

The famous phrase “Let them eat cake” has often been attributed to Marie Antoinette, highlighting the Queen of France’s disregard for the starving peasants’ plight, which helped contribute to the French Revolution in 1789. In reality, the phrase was recorded as early as 1765 by Jean-Jacques Rousseau. However, it does serve to highlight how dangerous it is to underestimate the impact of a starving population. History is filled with examples of political unrest attributed to this issue.

As food inflation rises around the world, and the cost of living increases, we have already seen governments begin to recognise this very concern.

So how did we get here, and what were the drivers of this current crisis? And from an investment point of view, what can we do to insulate portfolios against food inflation, especially in an environment of emerging food ‘nationalism’?

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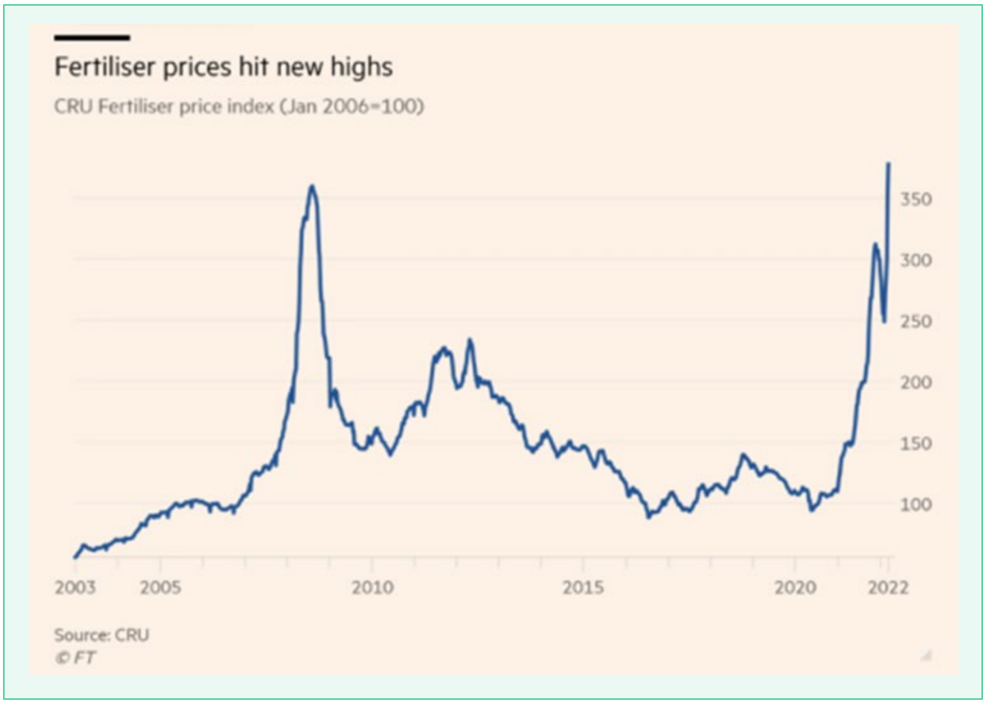
Supply and Demand

The main cause of the recent increase in food inflation stems from the Russian invasion of Ukraine, one of the world's largest exporters of wheat. Ukraine accounted for over 10% of global wheat exports in 2021[1]. Following the invasion, estimates suggest that Ukraine wheat exports will drop between 35% and 65%[2]. Ukraine's exports are being hampered by a Russian Navy blockade in the Black Sea. The sanctions imposed on Russia are also having an impact. Russia produced 17% of all global wheat production in 2021 and is the world's largest producer of fertiliser, which increased sharply as a result of sanctions (Chart A)[3]. The war has also contributed indirectly to rising food inflation, with rising energy prices increasing the cost of production.

Chart A – Fertiliser prices



Source: Financial Times

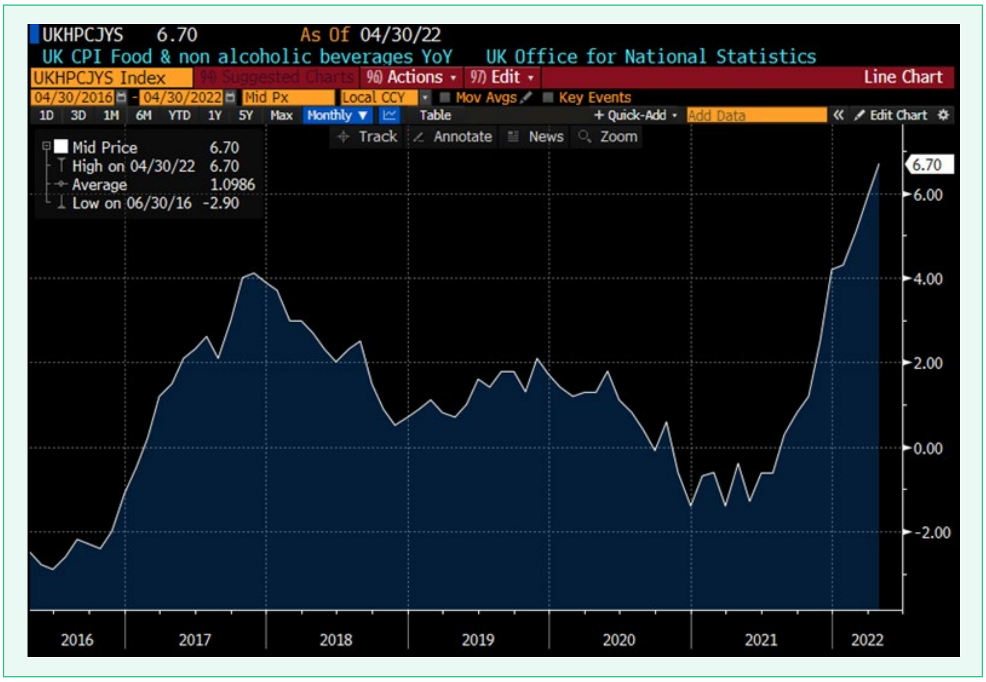
However, the war alone is not the sole contributor to food inflation. Extreme weather (which many attribute to climate change) has also been part of the problem. Recent floods in New South Wales and Queensland in Australia have severely impacted agricultural production, creating shortages of fresh fruit and vegetables. A shortage of lettuce in Australia has become so severe that KFC in Australia announced that they will start using cabbage as a substitute in their products. In addition, supply lines for all products have come under severe pressure in the post-COVID-19 environment, creating pockets of supply disruption which has had a knock-on effect on most food prices. For example, in December 2021, McDonalds in Japan and Asia started to ration French fries to prevent shortages due to supply line disruptions, including those attributed to flooding in Canada[4].

[1] Source: Forbes 19th May 2022
[2] Source: Guardian 6th May 2022 and Forbes 19th May 2022
[3] Source: Forbes 19th May 2022 and Bloomberg 24th May 2022.
[4] Source: Guardian 21st December 2021

From Globalisation to Protectionism

Food inflation is rising around the world. In the UK, food inflation is currently running above 6% per annum (Chart B), which is having an impact on disposable income and contributing to overall concerns on the cost of living.

Chart B – UK CPI Food & Non-alcoholic beverages

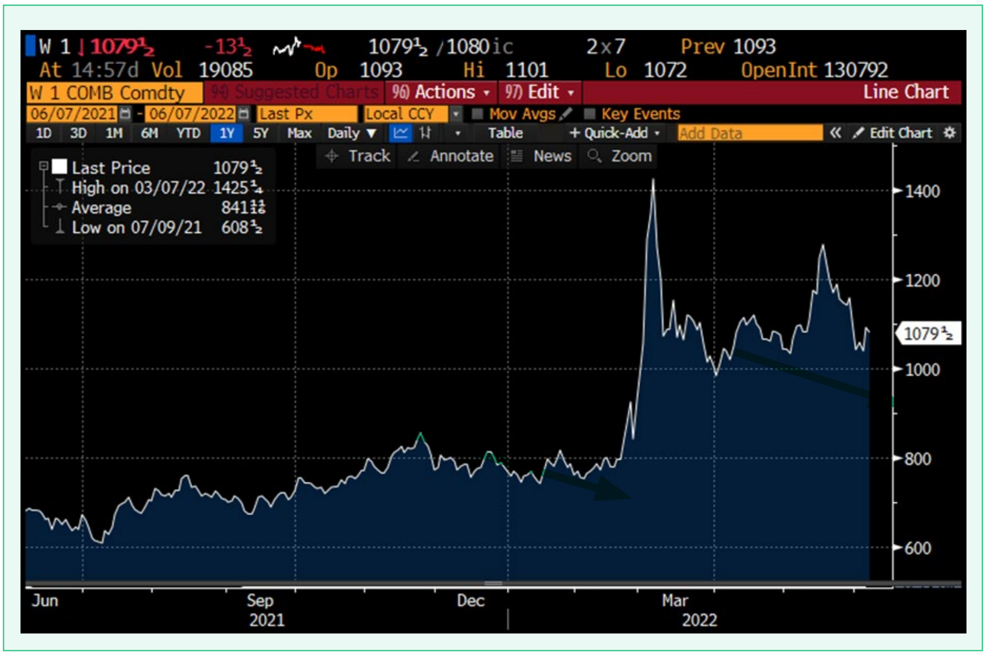


Source: Bloomberg

Similar levels of food inflation can be seen in other developed nations as well. It is in developing countries, however, where food inflation will have the greatest impact. The rating agency S&P Global produced a report suggesting that the "global food shock" is likely to create social unrest in emerging market countries for years to come. Some governments in emerging markets have already started to impose protectionist policies, to ensure they have sufficient food for their own population. For example, India announced a ban on wheat exports in May 2022 after the wheat crop was affected by unseasonably hot weather. Wheat prices (as demonstrated by the front month Wheat futures contract in Chart C) spiked at the end of February due to the Russia-Ukraine war, and then again in May after India's export ban.

[5] UK CPI Food & non-alcoholic beverage Index, published by the UK Office for National StatisticsSource:
[6] Source: Financial Times 1st June 2022

Chart C – Wheat futures prices



Source: Bloomberg

Indonesia announced a ban on exports of palm oil on 28th April (although subsequently lifted the ban in May) in an attempt to control soaring domestic cooking oil prices. In June, Malaysia announced that it would reduce the number of chickens it would export due to rising prices in the country. Although the aim is to control rising chicken prices in Malaysia, it is likely these increases will impact Singapore in turn, who import a third of their chicken supplies from Malaysia. These types of protectionism policies may help to control food inflation in the short term, but they usually have a large impact on global food prices.

The risk is, of course, that rising food prices contribute to deeper social issues, as demonstrated in Sri Lanka this year. The South Asian country was already under pressure, especially as one of the country's main contributors to the economy, tourism, suffered greatly during the coronavirus pandemic. The government borrowed heavily to support the economy, and rising interest rates are creating a larger debt burden, restricting the government's ability to use resources to control food prices.[7] Rising food and fuel prices have led to social unrest in the population, including riots at times. On 19th May 2022, Sri Lanka defaulted on its debt payments for the first time, and it may prove to be a proverbial canary in the coalmine of more issues to come for this nation, and other countries of similar circumstances.

What to do

Food inflation appears to be here for some time. The war in Ukraine is unlikely to end quickly, and Russian sanctions are likely to continue, creating a longer-term supply issue

[7] Source: Financial Times 1st June 2022

for wheat and fertiliser. So, what can you do as an investor in terms of hoping to insulate your portfolio from this challenging environment?

The obvious answer is to gain exposure to the commodity assets directly, particularly soft commodities (defined as commodities that are grown rather than extracted or mined). There are soft commodity ETFs in existence although they generally invest in futures contracts. It is difficult to get direct exposure to commodities in the UCITS space, where funds cannot hold commodity futures, although there are some funds offering exposure to food and agriculture products via equities. However, this is a fairly niche part of the market and funds can provide widely different return profiles. This means that investors need to have a full understanding of how the fund invests. Intelligent research and understanding of fund behaviour and profile is imperative to ensure that investors attain their desired exposure.

Alternatively, investors could gain exposure to food inflation via wider natural resources funds, incorporating energy and mining stocks in the portfolio construction. This does allow some exposure to the space, combined with some diversification with other commodities, as the fund manager can switch allocations to each part of the natural resources sector at their discretion. As above, proper research and due diligence is essential to ensure that the fund provides the expected exposure(s) and that any positive return from food inflation is not just offset by negative returns in other parts of the space.

Even if direct exposure to food inflation is not desired or achievable, investors should continue to be aware of the longer-term risks that continuing food inflation may create. Although the Sri Lankan civil unrest, and default on their debt, is not likely to impact many investors' portfolios, it is a warning sign. The next country to experience these issues may have a bigger impact on the markets. There are already signs of increasing stresses in countries like Pakistan (currently reducing the working week due to an energy crisis) and Iran (due to rising food prices). This does not mean that we expect a wave of social unrest and emerging market defaults. Some countries, particularly food exporters, may thrive in this environment. However, the risk of political instability has notably increased, and the impact of protectionist policies around food supply may create unintended consequences. Vigilance is required, therefore, to keep abreast of the longer-term impact that food inflation may have on society, and the markets in turn, so that investors are able to protect their portfolios.