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Report Highlights:

General Information:

On March 14, Premier Wen Jiabao pledged to cap inflation by restraining excessive capital in the market which has driven real estate, raw material, and food prices to new record levels in a nationally broadcast press conference following the People's Congress session. In 2008 and again in early 2011, the central government tightened lending to curve speculation on commodity prices. China's national producer price index (PPI) rose 7.2 percent in February 2011 year-on-year, the highest level since October 2008 according to official figures. At the same time, the Consumer Price Index (CPI) climbed to 6.9 percent. In South China's agricultural sector both imported and domestic inflationary pressures are a concern for provincial authorities. But, how will China shelter itself from these "imported" pressures originating from higher global commodity prices, including crude oil and staple food such as soybeans and soybean meal?

Although the average price of soybean oil and pork has only fluctuated slightly since the end of 2010, the landed soybean and soybean meal prices has increased on average of 11 percent and 6 percent respectively. The landed prices for Canadian potash imports (used for fertilizer production) also increased by 9 percent. According to our trade contacts, to ease imported inflation pressures Guangdong provincial officials are proposing national authorities consider:

1) Lowering import tariffs on staple food items such as soybean and soybean meal.
2) Diesel subsidies for farm equipment are currently being provided by government.
3) Other subsidies might include farm equipment purchases, grain storage rebates, and various forms of transportation subsidies.
4) Developed a pilot program for farmer direct-sale outlets encouraging supermarket direct purchasing from farmers. (*If successful, the program's largest beneficiary would be large-scale integrated producers which are able to produce a better quality and safer product at a better price*.)

Adding to the billowing of the PPI, the national crude oil price, which this year alone increased 3-5 percent is impacting farming costs from fertilizer to marketing and transportation across the entire food production supply chain. Fertilizer costs in major grain producing provinces increased on average by 15 percent in 2011. To add to the equation, in 2011 national domestic minimum wages increased on the average of 17 to 20 percent and labor shortages have created a fiercely competitive labor market amongst provinces given that there is no national fixed minimum wage rate. The highest bidder, the city of Guangzhou has the highest national minimum wage rate at $200 (or RMB1300) a month.

At the same time, during Premier Wen's press engagement, he mentioned China would improve logistics for agricultural products in an effort to curb rising food prices. Provincial governors will be made responsible for the overall agricultural supply markets which mean provincial government will be paying closer attention to PPI increases. Municipal governors on the other hand will be held accountable for staple food supply markets and CPI increases. For example:

- On March 10, Huizhou (in Guangdong Province) municipal government allocated $460,000 (RMB3 million) in a subsidy program to expand vegetable farming and support construction of a new 2,500 ton capacity refrigerated warehouse facility.

- On March 18, in efforts to assuage the surging CPI pressure, Guangdong provincial government vowed to invest $69 million (RMB450 million) from 2011-2013 to improve agricultural product distribution to encourage establishments of “farm-to-supermarket direct supply” and “low price outlet stores (for agricultural products)”.

Comment: The positive externality of this program is that the local cold chain industry (refrigerated storage and transportation) will soon see significant improvement given the elimination of intermediary traders that handle agricultural products from the farm to local markets. Fewer handlers in the food supply chain will make it easier for government officials to inspect for quality and enforce food safety laws. Additionally, government hope this farm direct initiative will curb hoarding activity that took place in 2010 namely for vegetables and meat products and that contributed to price hikes. Authorities realize that any potential food shortages or drastic price surges would endanger social stability and could potentially incite civil unrest.

-In early March, CCTV openly urged the Guangzhou government to lower toll charges in an effort to reduce the climbing CPI and PPI. On March 23, 2011, the Ministry of Transportation pledged to make a change to the current situation announcing non-toll roads would account for more than 96 percent of the country's road mileage in the future. China now has 100,000 kilometers of toll roads, accounting for 72 percent of the world’s total. Furthermore, toll charges are also among the highest worldwide. It is more expensive to ship a container of goods from Guangzhou to Beijing by truck than to ship the same from the U.S. west coast to Guangzhou by ocean vessel.

Conclusions: Irrespective of the veracity of these accusations, intermediate traders, as singled out in Premier Wen’s March 14 address are the central government’s culprits to blame for rising food prices. Funding for direct farm programs is being strongly encouraged in the food retail sector; however, before these programs are successful, greater guidance and extension services to countryside are needed to ensure safety, quality and consistency in the production chain. In the long run, the benefits of direct farming programs will be manifold, though in the short term, China will engage in more aggressive grain and oilseed purchasing strategies given higher international oilseed prices to meet domestic demand for high-protein feed and high-quality vegetable oils.