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As commodities spike, USDA softens food inflation forecast

U.S. food companies reluctant to lift prices as consumer spending remains weak

By Matt Andrejczak, MarketWatch

SAN FRANCISCO (MarketWatch) -- Consumers should continue to see low prices at the grocery store, based on a forecast from the U.S. Agriculture Department, which expects food inflation in 2010 to be at the lowest level since 1992.

Price spikes in the futures market for agricultural commodities -- ranging from wheat to hogs -- have been stoking fears food makers will raise prices to cover manufacturing costs. But the USDA lowered its food price forecast late Wednesday.

The USDA is calling for food prices at supermarkets and other retailers to rise 0.5% to 1.5% this year. That's down from 1.5% to 2.5% increase it forecasted June 25. In 2009, so-called food-at-home prices edged up 0.5% after rising 6.4% in 2008 and 4.2% in 2007.

Consumers can expect to pay more for meat at the store.

Pork prices are pegged to be up 3% to 4%, following an 18-month period in which U.S. meat producers have aggressively cut output and hog inventories to stem losses. This has spurred a 62% increase for lean hogs in the futures market over the last year.

"Increased inflation for most meat products in 2010 is a strong possibility," the USDA said.

In addition, prices for sugar and sweets could be up as much as 3%, dairy products up to 2.5%, and cereals and bakery products as much as 2%, the USDA reported.

Some of the largest U.S. food makers are taking some precautions already to protect themselves against surging commodity prices. For instance, Sara Lee (NYSE:SLE) said this month it plans to raise prices for its breads, deli meats and coffee.

J.M. Smucker (NYSE:SJM) has raised coffee prices 13% since May, while Kraft Foods (NYSE:KFT) upped prices for its Maxwell House coffees.

Despite some product-price hikes, brand-name packaged food companies are reluctant to boost prices as they fear losing market share, according to food industry sources.

This year, food makers have been heavy discounting their products to lure shoppers, boost sales and fend off advances from cheaper store brands. The approach has had mixed results, with volume growth still sluggish for some food companies.

Price cuts come as July marked the ninth consecutive month that wholesale food prices exceeded those at the retail level, according to Brian Todd, president of the Food Institute. This indicates supermarket chains and other food retailers continue to absorb many of the costs they are incurring, he said.

Typically, when commodity prices rise for a prolonged period, it takes several months before those price gains find their way to grocery-store shelves.

Robert Hill Jr., chief executive of Acosta, a sales and marketing consultant for major food makers and grocery stores, said price increases have been slow so far this year.

"We have not seen many price increases come through yet," Hill said in an interview Wednesday. He said "discounting will remain fairly prevalent" for the rest of the year.

In the past week, food companies contacted by MarketWatch -- Ralcorp (NYSE:RAH) , H.J. Heinz (NYSE:HNZ) , and General Mills (NYSE:GIS) -- declined to comment on whether they plan to raise prices with commodity costs going up.

ConAgra Foods (NYSE:CAG) said it might raise prices.

"We're watching commodity prices closely, and we will take price increases to reflect increases in commodity costs, as needed," spokeswoman Teresa Paulsen said in an email. "Any price increases would be competitive, and we'd still be providing consumers with terrific value."

A spokesman for Campbell Soup told MarketWatch Aug. 5 the company is hedged against the spike in wheat prices. The person said Campbell does not plan to raise retail prices for its bread and crackers sold under the Pepperidge Farm brand.

Campbell (NYSE:CPB) and Heinz both report earnings next week and are likely to be pressed by analysts on the issue again.