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Grain drain?

Consumer price index (CPI) inflation in China is again above the official target of 3 per cent, chiefly as a result of mounting price pressures within some food categories. Grain prices were 11.8 per cent higher in July than a year ago, meat and poultry prices rose 4.1 per cent, while vegetable prices were 22.3 per cent higher. On the whole, food inflation registered at 6.8 per cent, compared to a 1.6 per cent increase in non-food prices. Food collectively accounts for around a third of the country's CPI basket.

Following the droughts in Russia, devastating floods in China, and other disruptions in global agriculture, it would seem natural to associate the mainland's food inflation with these weatherrelated developments. The actual situation is more complicated. Under normal circumstances, China's grain market is relatively insulated from international fluctuations due to a policy of selfsufficiency, a regulated grain marketing system and the use of government reserves as a stabilising instrument. A notable exception is soya beans. China's net imports of grains are dominated by soya beans, with average net inflows of 3.9 million tonnes per month this year. In the first half of the year, abundant supply put downward pressure on global prices but, in July, dry weather in the US brought the spot price up 4.7 per cent in the US. The US Department of Agriculture estimates that the global soya bean crop in 2010/11 will reach the second-highest level on record, and spot prices later in the year could fall significantly.

In recent years, there has been much anticipation of a shift in China's position within the global corn trade from a significant net exporter to a net importer. Yet, the policy of self-sufficiency suggests that imports will primarily serve to fill domestic supply shortfalls and contain domestic prices. This seems to describe the current situation, following drought damage last year and considering the possibility that this year's harvest may be weaker than official projections indicate.

Looking domestically, the overall extent of production losses from recent flooding is difficult to estimate. However, of the three major grain crops, rice is expected to experience the biggest impact. Estimates suggest that output for the current harvest could be reduced by 7 to 10 per cent year on year. Nearly two-thirds of China's annual rice output is attributed to the middle season (harvested in September), but even so, food security is not expected to be a major issue. In comparison, corn harvests are often strong in the aftermath of big floods, while China's annual wheat output is overwhelmingly produced during the winter wheat harvest. Compared with 2007-2008, when food-driven CPI inflation peaked at 8.7 per cent in February 2008, domestic supply conditions should gradually return to normal this year. This is due to expectations of a generally

good grain harvest for the full year, and greater government intervention in the pork market to contain extreme price fluctuations.

China's rapid growth has meant rising incomes and more complex diets, notably the increased consumption of meat. At the same time, scarce agricultural land, environmental degradation and antiquated farming practices contribute to problems with supply, compounded periodically by natural disasters.

In coping with rising demand, China has resorted to higher imports of "feed grains" and achieved better efficiency in converting grain to meat, but there is still room for improvement. Much of this could be achieved with the use of genetically modified crops. China has made significant progress in introducing modern agricultural techniques, though the pace of change has been tempered by concerns about rural unemployment. There is a trade-off between food security and comparative advantage and how this plays out in the coming years will have a considerable impact on the rural sector and economic rebalancing.

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