

Food price volatility and its drivers – setting the stage

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Presentation

- What is price volatility, and why do we care
- Price trends, volatility and causes
- Speculation and price volatility

Food price volatility, what is it?

- Volatility: variation of price over time
- Volatility – variability and uncertainty
- Agricultural commodity markets are volatile
- Price movements and market efficiency
- The issue is “excessive” price volatility

Why the interest in food price volatility

- Macro and micro effects
 - Governments: LIFDCs, LDCs –food import bills
 - Consumers and producers
 - Livelihoods and food security impacts
- Increased and frequent volatility leads to sub-optimal investment

Evolution of food prices

FAO Food Price Index

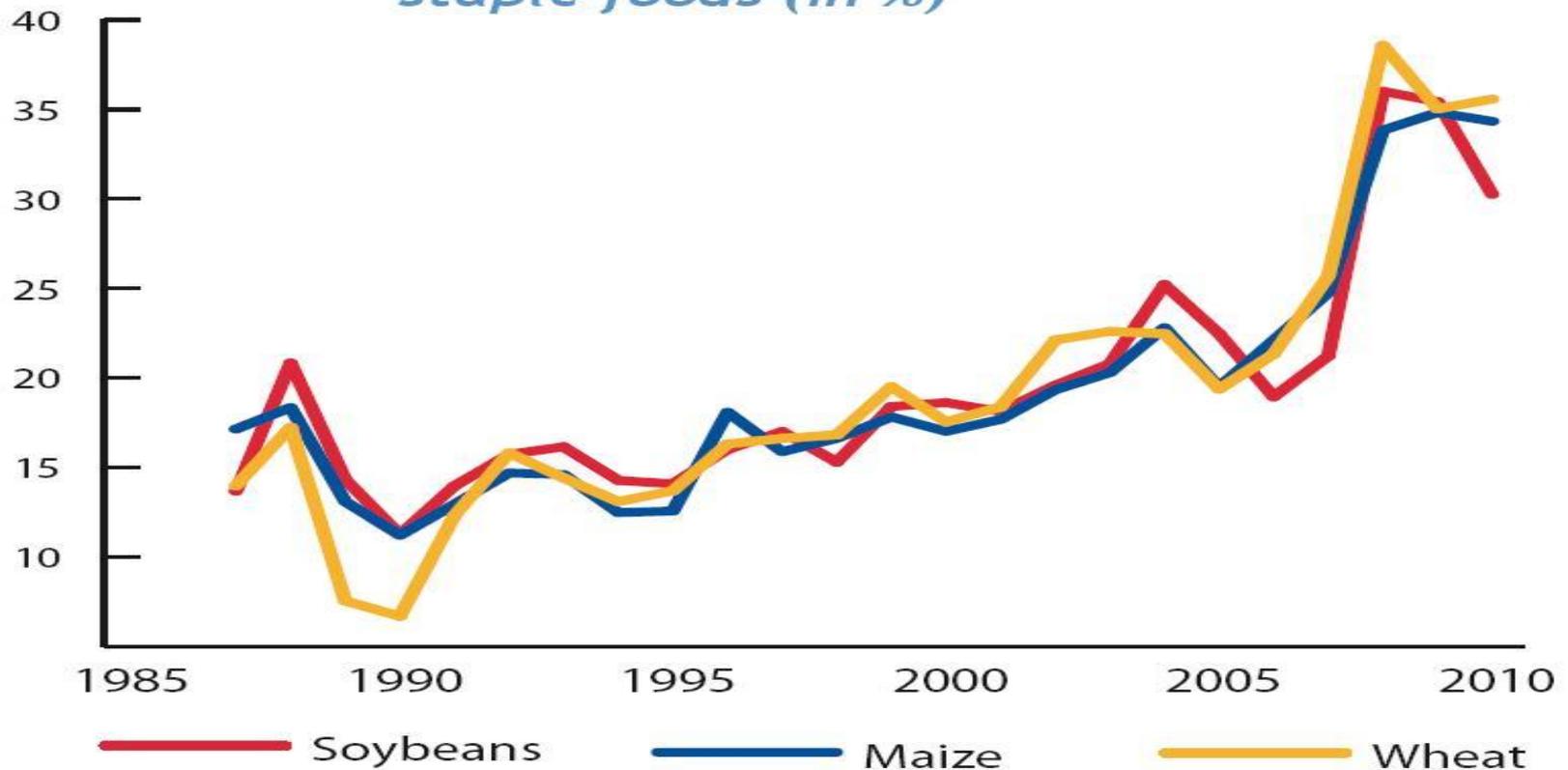
2002-2004=100



* The real price index is the nominal price index deflated by the World Bank Manufactures Unit Value Index (MUV)

Food price volatility

Implied price volatility of selected staple foods (in %)



Source: FAO (2010)

Note: Implied volatility represents the market's expectation of how much the price of a commodity might move in the future.

Factors behind price volatility

- Inelastic demand and supply
- Variability of production, migrating to less resilient regions + climate change
- Low stock levels / stock-to-use ratio
- Energy markets – stronger linkages
- Policy and panic
- Exchange rates

Derivatives markets and agriculture

- Commodity exchange markets designed to make physical markets work better:
 - Risk management
 - Price discovery
 - Liquidity
- *... but*
- Financialization of commodity markets
- Commercial hedgers / non-commercial investors

Does speculation drive price volatility?

“Yes”

- Deregulation in the US in derivatives markets in 2000
- Significant increase in commodity index investment
- Speed of price changes

“No” (or not sure)

- Many plausible and well documented contributing factors
- Counterexamples from other commodities and exchanges
- Evidence is mixed

Conclusions, and questions

1. Price volatility has increased, and so has activity in agricultural derivatives markets (correlation vs. causation)
2. Many factors affecting multiple markets and actors in very different contexts and ways. How to address this?
3. Why the difficulty to capture the influence of speculation on price volatility? (data, methodology, market complexity...?)
4. Regulating speculative activity? –market good and market ill
5. How to ensure regulation serves to guard against excessive speculation and does not affect good market functioning?
6. Also need to tackle the root causes of price volatility: increase investment, achieve sustainable productivity growth