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## Betting the farm

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### Climate change may drive food prices higher

WHAT would happen if pigs could fly? Bacon would go up. The old schoolboy joke springs to mind when one starts to think about some of the bizarre ramifications of global warming.



To recast the joke: what would happen if global temperatures rose?

Bacon would go up (and beef as well). Or at least that is the conclusion of Francisco Blanch, a Merrill Lynch commodity strategist.

The chain of reasoning is as follows. High oil prices, a desire for energy security, and regulations designed to reduce carbon emissions, have prompted governments to favour ethanol as an alternative to petrol as a motor fuel.

In Brazil, the ethanol is a by-product of sugar production; hence some very volatile moves in the sweet stuff over the last year. In America, thanks to the farm lobby, ethanol is a by-product of corn production.

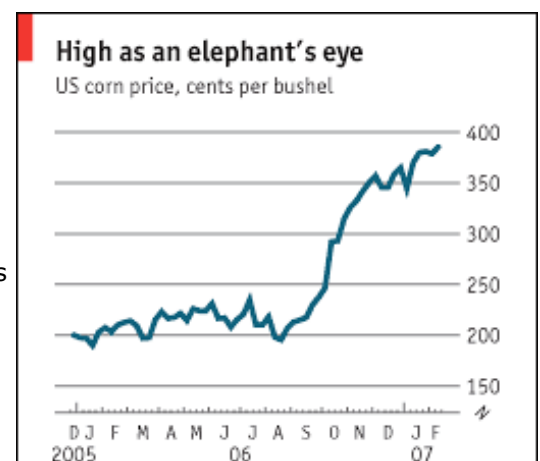
In 2001-02 only 706m bushels of corn were used for fuel in America. In the 2006-7 season that figure looks likely to treble, to 2.15 billion bushels. And, as demand shoots up, global corn inventories are at their lowest level in almost 30 years.

What about other agricultural products? Global warming may be having a further impact here by virtue of the drought in Australia (part of a long-term trend, rather than a one-off disaster), which has forced up wheat prices. High corn prices are also encouraging farmers to rotate their crops away from soybeans, and are likely to force prices for that crop higher.

All of the above (corn, soybeans and wheat) are key parts of the feed chain for cattle and pig farmers. And thus, inevitably, they will drive up livestock prices. There is a lag involved. Merrill estimates that, if grain prices rise by 30%, livestock prices will jump 10% after a period of three to six months.

It does not really matter whether cattle farmers have the market position to pass on higher grain prices to their customers. Even if they do not have that power, the result will be that they will raise fewer cows and pigs. That may already be happening with a fall in the numbers of cattle and pigs placed on feed. Demand for beef, ham and bacon is unlikely to suffer. As Asian countries grow wealthier, they are likely to move to more meat-based diets.

The knock-on effects may go even further. Higher food prices may give an upward push to headline inflation, prompting central banks to raise rates (or not lower them) in response. In turn, that may act as a brake on global economic growth. Furthermore, to the extent that consumers need to spend



more money on food, they will have less money to spend on other goods and services.

Source: Thomson Datastream

There are some long-term questions to consider. As most experts agree, it is simply not plausible for America to gain energy security by switching from oil to corn-based ethanol. There is not enough agricultural land available. Nor is it clear that ethanol is really that much greener, given the energy needed to produce it.

Ethanol is popular because it appears to be an easy option. It does not require higher taxes or rationing, it keeps the farmers happy and it makes the government look like it is doing something. Alas, dealing with global warming is likely to be more painful.

But look on the bright side. With equities close to, or at, record peaks, bond yields at historical lows, property looking pricey and metals coming off the boil, there is one set of products that just might surge in price. Forget dotcoms, forget biotechnology. The next boom might just be in pork bellies.

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