

Retailing

This Deflation Has Grocers Fed Up

- Competition creates a bargain bonanza in the food aisles
- "It starts to border on irrational pricing"

Call it the Great Grocery Store Giveaway of 2016. In Austin, **Randalls** supermarkets slashed prices for boneless beef ribs by 40 percent, to \$3.99 a pound. Not to be outdone, rival **H-E-B** charged \$1-a-pound less. During grilling season, **Albertsons** advertised buy-one-get-one-free specials on USDA choice petite sirloin steak—a deal you don't normally see on finer cuts of meat.

Still, such bargains pale compared with what a dollar and change can buy at grocery stores these days. In North Bergen, N.J., you can pick up a dozen

eggs at **Walmart** for \$1.14. A mile away at **Aldi**, the Germany-based discounter, shoppers can actually break the buck: 12 eggs for 99¢. A year ago, they'd have paid three times as much, on average.

In a development almost unheard of outside a recession, food prices have been below year-earlier levels for nine straight months in the U.S. through August. It's the longest streak of declines since 1960, with the exception of a period following the Great Recession. Analysts credit low oil and grain prices, as well as cutthroat competition between supermarkets and discounters.

"The severity of what we're seeing is completely unprecedented," says Scott Mushkin, an analyst at Wolfe Research who's studied grocery prices for more than a decade. "We've never seen deflation this sharp."

At first, falling prices helped grocers. Slumps in global commodities markets pushed down the cost for many meats and packaged foods, initially boosting grocers' profits. But deflation has since turned ugly for the industry, with some retailers pushing steep discounts to lure more customers into their aisles. The price war, led by Walmart, the nation's largest seller of groceries, has resulted in bargains for shoppers while squeezing stores' profits.

"It starts to border on irrational pricing," says Jennifer Bartashus, an analyst at Bloomberg Intelligence. "People are lowering prices just to draw traffic, without thinking about their margins."

Supermarkets are facing competition not just from Walmart and Aldi but also dollar stores and online retailer **Amazon.com**. It could get worse. **Lidl**, one of Aldi's rival food discounters in Germany, is building three distribution centers on the East Coast and plans to open U.S. stores by 2018. Even **Whole Foods Market**, dogged by a reputation for being expensive, has been trying to compete more on price through digital coupons and promotions on items such as beer and produce.

Mushkin of Wolfe Research recently found that prices of a typical basket of grocery items in Houston had fallen almost 5 percent in the past year. He credits in part the discerning behavior of shoppers such as Manny Sinclair for the declines. On a weekday lunch break, the 43-year-old contractor

Groceries Get Cheaper

Year-over-year change in prices of food at home



Price change, from August 2015 to August 2016

Eggs	-37.9%
Beef and veal	-7%
Milk	-4.9%
Coffee	-3.8%
Apples	+10.3%

DATA: BUREAU OF LABOR STATISTICS

stopped by a Walmart supercenter in Secaucus, N.J., to pick up turtle food and paper towels.

Sinclair typically buys groceries at his local **ShopRite** supermarket but has recently noticed the steals available at discounters. He glanced at the meat case, where a 12-pack of angus-steak burgers fetched \$15.82 and grass-fed ground beef could be had for \$4.96 a pound. Sinclair was intrigued, but with the classic logic of a shopper in an age of deflation, he figured he might find even lower prices elsewhere. Along with two Walmarts, a Target, and an Aldi, the area has a **Family Dollar** store that features a small refrigerated food section. Says Sinclair: "Wherever I find the good deals—that's where I'm at."

In recent years, **Kroger**, the largest grocery chain in the U.S. with almost 2,800 stores, cut prices to compete with Walmart and managed to increase its market share and sales. But deflation has been hard on the company. Its stock has lost more than a quarter of its value this year as sales growth has slowed because of price cuts. Chief Executive Officer Rodney McMullen has expressed frustration that many customers

Companies/Industries

don't even notice the falling prices.

"The other thing that's always hard is getting your message out, because it's fascinating—in our research, most people are saying their basket of goods costs more money," McMullen said on a call with analysts in September. A possible reason for his lament: Food on average makes up only about 15 percent of a consumer's budget. Except for gas and other energy-related items, prices for most other goods are going up, if only modestly.

At the same time, restaurant food isn't getting cheaper. That can make for some strange contrasts: In Chicago a pound of Dunkin' Donuts coffee sells for \$4.99 at a **Jewel-Osco** store, less than the cost of a venti pumpkin spice frappuccino at Starbucks. Albertsons owns Jewel-Osco, as well as Randalls, home of the cheap Texas ribs. Fast-food chains also have recently blamed cheaper groceries for stealing customers.

Still, some consumers aren't biting. Elena Rosa, a 63-year-old retired health aide, was blasé when she steered her shopping cart past the refrigerator case at Aldi in North Bergen. She paused, noting the dozen eggs for less than \$1—"That's a good price," she said—before moving on without buying.

—Craig Giammona, with Lauren Etter

The bottom line Food prices in the U.S. have been below year-earlier levels for nine straight months. The price cuts have been bad for retailers' profits.