BTG Financial Consulting

INDUSTRY UPDATE

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Agriculture: complex and unpredictable

In the third of a series of agriculture updates, BTG Financial Consulting looks at the cyclical peaks and troughs in supply and demand in the farming sector, and the impact of Brexit on international trade.

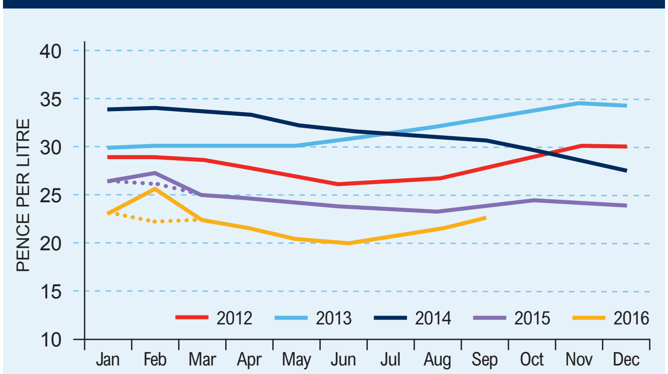
British food competes on the world stage and while that brings with it immense opportunity, it also exposes the nation's farmers to a global market. All industries that operate in global markets face periods of price volatility and this includes the farming industry.

Dairy's Mini Recovery

The much-maligned dairy industry is finally showing signs of recovery. A sustained period of low prices has seen many producers selling commodities at prices significantly lower than the cost of production. This has led to even the most efficient producers questioning their long-term sustainability.

The most recent Defra figures to September show that UK average farm gate milk price stood at 22.58p per litre – a 5.2% (1.11p per litre) increase on the August average price. While this remains 4.8% lower than the same month last year, it is the third consecutive monthly increase.

UK Farm Gate Milk Price (Pence per Litre)*



* *For February 2015 and 2016, price shown both with and without retrospective bonus payments.*

Source: DEFRA, UK Price, Volume and Composition of Milk – Sept 2016

UK supply has fallen at a consistent rate of 6–7% per month since April, and September milk production decreased 6.4% on the previous month – a 9.7% decrease on the same period last year. Milk production volume is at its lowest since February 2013.

Prices have a long way to go before some businesses return to break-even levels and maybe a small profit but with global production significantly decreasing, the recovery process seems to have begun.

Arable Farmers Still Feeling the Pinch

Better times may be ahead for arable farmers. Official harvest results for the year were pending at the time of writing, but, anecdotally, yields are above what was expected.

Globally, grains and oilseeds remain oversupplied and, in the short-term, grain prices, which are nearly half what they were four years ago, are likely to remain static.

Of most concern for arable farmers is the withdrawal of key crop protection products, which is leaving many exposed to pest, disease and weed pressures that compete with the growing crop, damaging yields and quality.

Major agricultural chemical companies have been forced by the EU to take their products off the shelves due to concerns over the harm they may be doing to humans and the environment. In other instances, pests and weeds are evolving their resistance profiles and traditional chemistry is no longer controlling them.

What Britain's exit from the EU will mean for rules governing the licensing of chemicals for food production is unclear at this stage, but farmers are being encouraged to mix cultural and chemical controls into their farming practices to reduce their reliance on these products.

A case in point is glyphosate – a weed killer which is one of the only tools in the box for growers to tackle blackgrass, the number one weed threat for arable growers, particularly in the east and south-east of England.

Amid fears that the product is carcinogenic, attempts have been made to ban it from sale. In July, the European Commission decided to extend glyphosate's licence for another 18 months, but farmers are expecting to face a fresh battle to keep the Monsanto-manufactured product in the long term.

A Change in Egg Sourcing Policies

Free-range egg producers find themselves at a crossroads after all major retailers and food service companies announced the phasing out of sourcing eggs from colony production by 2025. The colony system replaced the traditional cage five years ago.

Nearly two-thirds of shoppers are now choosing free-range eggs in the supermarket aisle, and are paying a premium to do so, and the industry has enjoyed a significant period of growth.

But the announcement means that, on paper, eggs from upwards of 11m birds which are currently kept in colony systems will have to be replaced. The supermarkets' preferred replacement system has not been declared, leaving free-range producers concerned that their eggs will soon become the budget option, removing the premium return they budgeted for when investing in their businesses. Fears have also been aired that imported eggs could flood the market in the absence of a cheap UK alternative.

The British Free Range Egg Producers Association has warned that retailers must make the origin and production system of any eggs clear on-pack. Barn production, which allows the birds free movement inside the house, but no access to outdoors, is likely to become the value option, which free-range egg farmers hope will reaffirm their higher welfare proposition.

Dampened Enthusiasm?

Defra's figures which set out incomes from farming paint a fairly bleak picture for those considering an agricultural career. On average, more than half a business's profit is derived from EU subsidies, yet the next generation of farmers are keener than ever to get in to the industry.

Making the move from farm worker to owner or tenant, however, remains hugely problematic for those without significant capital or a family farm to take on.

The hunger of new entrants was aptly demonstrated by the National Trust which earlier this year offered tenants the chance to run a 720-acre Welsh farming tenancy for just £1/year for ten years.

There were 2,000 enquiries from across the globe, and 400 formal expressions of interest before the winner – a 38-year-old Welshman – was announced in August.

With average land prices still exceeding £8,000/acre in England, borrowing money to fund a start-up business set against a backdrop of uncertainty and low commodity prices is not a straightforward process.

The Scottish Government has made £1.8m available for 35 young farmers and new entrants to share, in order to help to fund buying land, equipment and livestock, or investing in infrastructure.

Meanwhile, in Northern Ireland, succession is an issue with half of all farmers admitting they have no successor, but young people saying that they are keen to get into the industry.

Brexit: A Problem or an Opportunity?

The European single market gives UK businesses access to the world's largest economy with more than 500m people. As well as customers, free movement of labour provides many UK farm businesses with crucial access to seasonal and permanent workers.

Despite UK agriculture's deep dependence on the EU, the majority of the farming community is understood to have voted to leave on 24 June.

Polling carried out by *Farmers Weekly* before the referendum indicated that 58% of farmers were planning to vote leave with just 31% in favour of remain.

For some it was a protest vote. Farming has been through several years of volatility and, for certain sectors, the past 12 months has been among the most challenging in a decade. 'It can't get any worse', one farmer told journalists at an event where farmers' opinions were canvassed before polling day.

UK farm businesses have become heavily reliant on the annual Basic Payment Scheme. The latest figures from Defra show that 55% of UK total income from farming comes from Common Agricultural Policy (CAP) support payments.

The National Farmers' Union (NFU) says that in 2015 UK farmers received €3.084bn in direct support, and that they will have access to €5.2bn in rural development funds allocated from 2014-20.

Trading Internationally

The importance of a strong trade deal for Britain is also clear.

The Food and Drink Federation says that the UK is a net importer of agri-food products, totalling £39.6bn in 2014, but that it also exported £12.8bn worth of products. Approximately 73% of UK agri-food exports were destined for other European member states.

Exports are a vital market. For example, 38% of all lamb produced in the UK goes to Europe. France alone purchased more than £200m worth of UK lamb in 2014, the NFU says.

However, many farmers are viewing this summer's events as an opportunity to start afresh. They plan to help the Government broker new trade deals, create a subsidy system that frees farms of bureaucracy and make public services contracts that centre around sourcing British food at the expense of imports.

A huge amount is up for grabs, but the farming lobby is not the only one which has drawn up a wish list.

Countryside and wildlife groups are vying with farmers to get their voice heard while Defra decides how a replacement for the CAP will look.

Most farmers are preparing themselves for less money from direct support payments, which are currently made to them under Pillar One of the CAP.

But a question remains over whether the UK will follow the EU trend of asking farmers to do more stewardship of the countryside in order to attract subsidies.

The last CAP reform saw a huge switch in the budget from Pillar One to Pillar Two, and many lobbyists think protection of the environment should continue to come ahead of any direct support.

Labour Issues

Subsidies aren't the only thing on Defra's plate. Before the referendum, businesses that rely on large quantities of seasonal labour – predominantly fresh produce businesses – had called on the government to install a new seasonal workers' scheme.

The British Summer Fruits Association has called on David Davis to take note of the £1.2bn industry which relies virtually 100% on workers from Europe because British workers "do not want to get up at 6am and work on their hands and knees all day".

Much is to play for, but for now the implications of Brexit have arguably been positive.

A weaker pound has led to UK commodities appearing cheaper on world markets. Sterling fell to a 30-year low against the dollar, and continues to be significantly weaker than it was against the euro.

The average exchange rate between the euro and the pound in September determines how much money UK farmers get from the CAP, which is set in euros. Last year farmers got the worst rate in eight years, but with the weakening of sterling it is set to deliver a 16% increase in EU subsidies next year – worth more than £300m.

A predicted drop in land values has also failed to materialise. The UK's largest land agency, Savills, says values had already showed signs of a slowdown during the first half of 2016 when the average value of farmland across Great Britain fell by 2%. With international investor interest perked by the fact they can effectively buy UK farmland with a 15% discount, the average acre of land has held steady ever since.

Brexit is both a million miles away and just around the corner. Forward-thinking farmers are already looking at how they can ensure their businesses are future-proof and ready to perform in an independent Britain.

But, as businesses have seen all too clearly in the past decade, they are now exposed to many market forces and policies that are outside of their control.

Creating a level playing field that allows UK farmers to compete on the world stage must be front and centre of agriculture's campaign to shape the post-Brexit policy framework.

Whether it can make its voice heard among the plethora of campaign groups with their own aspirations and policies remains to be seen.

For Further Information

If you would like to discuss any of the issues raised in this update or would like to know further details about the services we provide to the sector, please contact:

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