Group Economics

Ulster Bank

Farming exchanges bad times for good, but what lies ahead?

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Last year was a year of many surprises – Brexit, Trump, Leicester winning the English Premier League, and Ireland beating the All-Blacks in rugby are just some examples that come to mind. The Northern Ireland economy also enjoyed an unexpectedly positive year in 2016, with many record-breaking performances, including in the labour market. But the turnaround in the fortunes of the agriculture sector is perhaps even more startling.

Looking slight further back, 2015 was a very difficult year for the agri-food sector. Indeed, it was something of an annus horribilis for agriculture. Total Income from Farming (TIFF) in Northern Ireland was down 42 percent year-on-year in 2015 and was at its lowest level since 2006.

Furthermore, in 2015, TIFF was almost 20 percent below the average of the previous 20 years, after accounting for inflation. The fall in 2015 represented the steepest drop in farming incomes since the BSE crisis in 1998 (-56%).

The fortunes of the sector though completely turned around in 2016. Total Income from Farming (TIFF) in Northern Ireland rose 21 percent last year, and there were also ongoing improvements in productivity – something that the rest of the Northern Ireland economy could learn from.

There have been a number of factors driving this. One is the change in the exchange rate, with sterling weakening significantly. This has been helping exports, supporting Northern Ireland's food industry in the UK market against Eurozone competitors, and more significantly has boosted EU CAP Payments, as these are paid in euros.

The weak sterling is of course a double-edged sword. Whilst it boosts exports, it also leads to inflation being imported, impacting on the cost-base of all kinds of businesses, including farming and food businesses. This inflation also feeds through to consumers and our own Ulster Bank Ulster Fry Index - which provides an indication of food price inflation – has returned to inflation for the first time in three years. Indeed, the cost of the items making up a cooked breakfast rose 2.8 percent in the past year, based on CPI (Consumer Prices Index). Following a two-year inflation holiday, it is clear that inflation is back and on three fronts: food, fuel and transport costs.

But, inflation aside, the nine months since the Brexit vote have been, broadly speaking, kind to Northern Ireland's farmers. This is largely due to favourable short-term movements in the Sterling / Euro exchange rate. But what about the Agri-food industry's prospects in the medium to longer term? Specifically, what lies ahead when the UK actually leaves the EU?

There has been much discussion around this issue, and there is perhaps not much point in rehearsing all of it. But one key factor is going to be how policy is taken forward at Westminster. What will happen to subsidies for farmers is obviously crucial, given the scale of subsidy that Northern Ireland receives in this respect. Will the government in Westminster be so generous? And to what extent will policy be devolved? The UK farming community benefited from the fierce lobbying of the EU by French and Irish farmers. Westminster is likely to be less receptive to farmers' pleas relative to their counterparts in Brussels.

There will also be a degree of volatility taken out of the equation with subsidies being paid in sterling rather than euro. This will remove the exchange rate factor and therefore uncertainty. But it will also mean no 'bumper years' i.e. like last year whenever sterling was very weak against the euro.

Perhaps most importantly will be issues relating to the border. There have been various discussions in relation to Guinness and what the border will mean potentially mean for the 'black stuff'. As we know, the stout is brewed at St. James's Gate in Dublin, but what's in almost every bottle and can of the stout crosses the border twice before reaching beer drinkers.

The ingredients come from all over Ireland to Dublin, where the water, barley, hops and yeast are mixed and brewed before being taken in tanker trucks the 90 miles north – and across the border - to Belfast. Then, it is bottled and canned before being sent back to the Republic of Ireland for distribution.

A similar situation occurs in relation to 'the white stuff'. Milk produced in Northern Ireland also crosses the border on various occasions. We are told that about a third of milk from cows in Northern Ireland is transported across the border for production into butter, cheese and infant formula. Sometimes it comes back again for sale.

What happens with the land border will clearly have a very significant impact on this food and drink sector business; and many others. Will tariffs apply, triggering price rises and / or a geographical relocation of some parts of the supply chain?

Freedom of movement of people alongside goods is an issue too. Access to the single market for labour poses a significant challenge for food processors. The industry is heavily reliant on EU nationals. A deal may potentially be done between the UK and EU enabling existing EU nationals in employment to stay. But what happens if and when they need to be replaced? Will the local labour market which hasn't responded to the demands of the sector in sufficient numbers in the past do so in the future?

In the past, realising economies of scale, on an all-island basis, to compete globally made sense. The UK's imminent exit from the EU could be a game-changer for this business model. Will we see more partnerships East-West rather than North-South? Given the scale of the UK's food deficit, Brexit could provide a significant opportunity for local agri-food companies to fill that gap. NI farmers could increase their market share in the GB market at the expense of their counterparts in the Republic of Ireland.

Alongside this opportunity is the potential threat from new trade deals between the UK and North / South America. Given the ongoing fiscal austerity and inflationary squeeze on household incomes, will the UK government be tempted to placate its electorate with a cheap food policy? Opening up trade with e.g. Brazilian beef may be good news for the household finances. But this gain will come at the expense of food producers.

Last year was a year of many surprises, and the year ahead is likely to throw up a few unexpected things as well. Agriculture will be on the front line in relation to the Brexit negotiations, and now that

Article 50 has been triggered, there are some crucial issues on the table for farming and food. Let's hope there are some positive surprises in the mix.

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