Group Economics

Ulster Bank

Agri-sector continues to make hay while the sun shines and the CAP still fits

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For 143 years, Northern Ireland has showcased its agricultural and food sectors at the Balmoral Show, now the largest agricultural and food event on the island. But the agri-food sector is more than a highlight within the May events calendar; it has been a major bright-spot for the economy during the wider economic downturn.

Whilst private sector output is some 16% below its Q2 2007 peak, output within the *Food, Drink & Tobacco* sub-sector has increased by almost 13% in real terms. Annual output figures for agriculture highlight that the volume of gross output increased by 2% year-on-year in real terms to £1.7bn last year; although relative to 2007, output is up just 0.5% in real terms.

Within agriculture, however, fluctuations in prices and subsidies mean the key performance measure is income and profitability. During the last financial year, Northern Ireland's total income from farming *(TIFF)* increased by almost 15% in real terms - over seven times the estimated rise for the UK. Since 2007, NI's TIFF has increased by almost one third in real terms and has almost doubled since 2006. This same 15% *(or +£1.1bn)* increase also appears in Northern Ireland's manufacturing sales and export figures. Since 2007/08; *Food, Drink & Tobacco (FDT)* sales have risen by the same margin *(up to 2010/11).* Conversely, manufacturing sales, excluding FDT, have decreased by almost £2.1bn or 21% since 2007/08.

Clearly the stellar performance of our agri-sector within the latest manufacturing sales and export figures conceals the sheer scale of the downturn elsewhere. *FDT* accounts for more than half of total manufacturing sales and 20% of all exports. At a market level, FDT sales to the Republic of Ireland *(RoI)* and Great Britain *(GB)* have surged by 29% and 17% respectively, in real terms, in the four years since 2007/08. Meanwhile, sales outside of FDT have tumbled. In particular, the RoI non-FDT market has seen exports plummet by a staggering 57% since 2007/08.

The surge in sales to GB and RoI largely stems from the significant depreciation of sterling against the euro, which follows the Bank of England's slashing of interest rates. Sterling averaged €1.41 in 2007/08 before falling to €1.13 in 2009/10, hitting a low of €1.025 in the process. From this perspective, the agri-sector was the chief beneficiary of the Bank of England's ultra-loose monetary policy stance. Not only did the exchange rate boost demand, it boosted incomes significantly too. The EU Single Farm Payment (SFP), fixed in euros, moved from almost 70p in 2007 to over 91p in 2009. Last year, the conversion rate was 86.7p which yielded an estimated £267m return for Northern Ireland. Looking ahead, however, the bumper SFP harvests of the past are likely to be much lower in the future. For example, this year's fix could be around 81p, if not lower. Furthermore, the sceptre of CAP reform draws ever nearer.

Looking at employment, the agri-sector has also bucked the wider trend. The agriculture and food processing sectors have seen employment levels rise by 3.4%, or almost 1,000, in the four years to December 2011, compared with job losses of almost 39,000 *(-5.3%)* economy-wide and falls of up to one third in the construction sector.

Against this backdrop, you would be forgiven for thinking that all things agricultural are positive and the sector should be shouting its success from the rooftops. But farmers are by nature cautious people and are quick to hide their light under a bushel. Given reasons to be cheerful, they will also quickly respond with reasons to be fearful. This is no bad thing, as it recognises the inherent volatility within the sector which experiences swings in output and prices, and therefore incomes. When things are good, it literally is a case of making hay while the sun shines. An appreciation of volatility, and playing the long game, runs through the agri-sector's veins.

Like other sectors, the key concern within agriculture remains inflation. Unfortunately, bumper demand has been accompanied by bumper rises in input costs. Historically, agricultural inflation has tracked the oil price. In March 2012, Brent Crude hit a record high in sterling terms of almost £80.4. It has since eased back to £73.3pb but this is still more than double the average for 2007 *(£36.20)*. These fuel price rises, linked to the exchange rate, have triggered rapid inflation in everything from fertilisers to meat. Indeed, we now see supermarkets with electronic tags on certain meat products, such is their value.

Whilst inflation remains a significant issue, the agri-food sector continues to benefit from strong demand, unlike many other sectors which are battling with the twin challenges of rising inflation and falling demand. Looking ahead, the rise in sterling should ease inflationary worries but the flipside is the erosion in some of the price competitiveness gained in recent years. Finally, while we have all become fearful of deficits, the current £18bn UK trade-deficit in food provides a great opportunity to grow our agri-food industry. For this reason, 2012's Balmoral Show, perhaps more than any other in its long history, may well see the cheer outweigh any fear.

Richard Ramsey,
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