Group Economics

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The grass is no longer much greener on the agri side of the fence

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There was a time when most sectors of the Northern Ireland economy looked on with envy at the environment in which the local agri-food sector was operating. The likes of heavy manufacturers were being hit by plummeting demand and soaring input costs, whilst the agri-food sector was by comparison basking in positively glorious conditions. Demand was strong and the weakness of sterling against the Euro afforded an envious competitive advantage against food and drink firms based in the Eurozone. The result was that whilst all of the key indicators for the economy in general were pointing downwards, the key indicators for the agri-food sector were very much on the up.

That was then; this is now.

Today, just a year on from the end of the extended sweet spot that the agri-food sector enjoyed between about 2008 and 2014, we have very much the converse situation in effect. Whilst the Northern Ireland economy in general has been enjoying something of a revival, the agri-food sector has been hit hard by the Euro's decline. Just as a weak Sterling and strong Euro had enabled Northern Ireland agri-food businesses to displace Eurozone companies in various markets, notably GB, in the preceding years, a stronger Sterling and weaker Euro are now favouring Eurozone, notably RoI, companies to the detriment of their Northern Ireland rivals.

In terms of primary agriculture, during 2014, Total Income from Farming (TIFF) in Northern Ireland fell by 17.4% in real terms, whilst gross output from agriculture was down 3.1%. Meanwhile Farm Business Income (FBI) saw a decline of 27% in 2014/15.

And the impacts of the exchange rate are not just being felt in terms of sales and margins; the agriculture sector receives its Single Farm Payment (SFP) in Euro, which means that it is worth less when converted into Sterling than it would have been even just a few months ago. This is making a challenging situation even more difficult. When the SFP rate is set at the end of September it is likely to be set around the 70p mark. This will yield the lowest payment in over a decade.

The exchange rate is not all bad news for the agri-food sector. Sterling has fallen by over 10% against the dollar over the last 12 months. As a result, agri-food produce, particularly meat, is attractively priced in the US and dollar denominated markets. Therefore whilst there will be fewer containers leaving our ports bound for the Eurozone market there may be more heading westwards.

Northern Ireland dairy farmers have been amongst those who have had it toughest of late. Prices received by dairy farmers are down approximately 40% relative to last year and recently hit a seven-year low. One of the sector's concerns is the ending of milk quotas by the EU, which were introduced 31 years ago to help prevent over-production. The fear is that this will lead to increased production and therefore drive down the price of milk further. However, given how low milk prices currently are, there is little commercial incentive for EU dairy farmers to increase production and depress milk prices further. Instead, we are likely to see the least efficient EU dairy farmers exit the market. Such a move would offer much needed support for milk prices.

The EU's sanctions against Russia triggered a retaliatory response from Russia on food imports from the EU, US and some other Western countries. This is having a significant impact on the EU agri-food industry. EU exports of food and agricultural products to Russia, which after the US is the EU's largest food export market,

totalled $15.8 billion in 2013, which gives an indication of the scale of Russian dependence on food imports. Fruit, cheese and pork are the top 3 largest categories of EU food exports to Russia.

In total, EU exports to Russia fell by more than a third in the first two months of 2015 relative to 2014. For Northern Ireland food and drink exporters, this represents a large market no longer available particularly for our cheese manufacturers. Northern Ireland manufacturing exports *(includes food & drink)* to Russia in 2013/14 were £110m. We export more to Russia than to either Spain or Italy. Within Europe, outside of the Republic of Ireland (NI's No.1 export market), only Germany, France and the Netherlands attract more Northern Ireland exports than The Bear. The sanctions also mean that all of the food and drink exporters from other countries who would have sold to Russia are now looking for alternative markets, therefore heightening competition within other regions in which Northern Ireland firms compete. The EU is set to review its sanctions with Russia in June. Given the recent positive diplomatic engagement between Greece and Russia, it will be interesting to see whether Greece vetoes any EU efforts to renew these sanctions against Russia.

Irrespective of what happens with the EU, Russia may persist with its ban on EU food imports anyway. The reality is that the Russian agriculture sector is very happy for EU imports to be banned, as it represents an opportunity for them to turn Russia into one of the world's 'breadbaskets'. So, there is little prospect of Russia re-opening as an export market for EU, including Northern Ireland, agri-food exporters any time soon.

All-in-all, the conditions in which the local agri-food sector is operating could potentially see it move in the direction of travel apparent in other industries. The collapse in the oil price triggered one of the biggest mergers of all-time - Shell's proposed £47bn purchase of BG Group - and more consolidation in the oil industry is likely to happen. The decline in the construction sector also led to some consolidation of note locally, with the recent announcement of the merger of Lagan Construction and H&J Martin. Could we see the same in the agri-food sector?

There is a strong argument for such a trend. The sector currently has an issue with price competitiveness and profitability, which could be alleviated by scaling up through mergers and/or acquisitions. Larger, all-island groups, for instance, would be much better placed to manage exchange-rate volatility, benefit from economies of scale, and compete internationally against larger competitors. They would perhaps also be better placed to deal with the changing landscape regarding the large supermarkets.

As the likes of Tesco and Sainsbury's have come under more and more pressure from the Lidls and Aldis of this world, their policy of local sourcing looks to be coming under pressure as they seek to boost competitiveness and to be able to offer lower prices to consumers. A significantly reduced product line, a feature of Lidl & Aldi, will also filter through the supply chain with smaller firms the most vulnerable to potentially becoming de-listed as suppliers. Conversely, the very large suppliers operating in national markets are likely to prosper. However, the Northern Ireland agri-food sector will argue that the traceability it currently offers is second-to-none and is very important to consumers.

Overall, the reality is that one of the major differences between the agri-food sector today and other sectors during the worst years of the global recession is one of demand. The sector doesn't have a demand problem, it has a volatility and profitability problem. In this respect, there are many global issues affecting it that it cannot control, so it needs to focus on what it can control. That means restructuring and potentially engaging in mergers and acquisitions. Traceability was an issue for the agri-food industry in recent years. Scalability is the key issue for maintaining competitiveness in the years ahead.

So whilst times are tough, and the grass is no longer significantly greener on the agri side of the fence, the long term prospects of the sector remain fundamentally sound, as long as it adapts.

Richard Ramsey
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