Ulster Bank

The grass is greener on the agri sector side of the fence…

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A potential *'Grexit'* (Greek exit), coupled with growing concerns about the Spanish banking system, triggered falls in European equity markets last week, with the Spanish stock market for instance eclipsing its 2009 low, now back at levels last seen in 2003.

Not surprisingly, these developments have led to a 'flight to safety' across a range of asset classes from equities to government bonds and currencies to commodities. In short, the euro has suffered whilst the dollar has prospered from risk aversion. The price of gold was on the rise again last week reversing its recent downward trend. However, the oil price has been moving in the opposite direction with the price of Brent crude reaching its lowest level of the year in both dollars and sterling. Clearly, the threat of a full blown euro zone crisis will impact on global growth prospects and the demand for oil.

Other safe havens have included government bonds. The price of 10-year German bunds and UK gilts reached record highs last week while the yield or interest rate paid to investors *(which moves inversely to the price)* fell to record lows of 1.4% and 1.8% respectively. When inflation is taken into account these represent negative real rates of return. These truly are uncertain times. Furthermore, anyone following the narrative from global policymakers will be aware that the severity of the current difficulties cannot be understated.

This message was a key theme at the *MoneyWeek* investment conference I attended on Friday. From the outset, delegates were reminded that the seriousness of our current economic plight was highlighted by the simple fact that the Bank of England interest rate has remained at its lowest level since it was established in 1694. Against the backdrop of inflation, and currency debasement via quantitative easing *(printing money),* the number one priority amongst investors is capital preservation rather than growth.

It was not all doom and gloom at Friday's conference, however, as a number of growth opportunities were identified. One of the most obscure investment recommendations was Indonesian art. Other opportunities expected to yield a positive return included agribusiness and forestry. This has added significance for the Northern Ireland economy given our exposure to this type of activity. Northern Ireland's *Agriculture, Forestry & Fishing* sector accounts for almost 1 in 4, or 16,285 of all VAT registered businesses within Northern Ireland. This compares with less than 7% for the UK as a whole.

In Northern Ireland, the agriculture, forestry and wider agri-food sectors have been one of the safest havens for economic performance *(in terms of job losses and output growth)* and indeed bank lending throughout the economic downturn.

Thankfully, Northern Ireland's over-exposure to the agriculture / agri-food sectors, relative to other UK regions, has been a blessing. Conversely, Northern Ireland's over-exposure to other sectors *(relative to GB)*, notably construction has been a major drag on the local economy.

Some sectors of the local economy linked to property/construction have seen output falls of 40% to 50% and 30% falls in employment during the downturn. However, other sectors, such as agriculture, have continued to expand throughout the wider economic downturn and have posted net job gains. For example, the agri-sector *(including agriculture and food processing)* has witnessed employment growth of over 3%, or 1,000 jobs, between Q4 2007 and Q4 2011.

No sector has been a safe haven from price rises. Inflation has been the blight of the agri-sector like everywhere else. However, this blow is somewhat softened by the fact that the agri-industry doesn't have a shortage of demand to contend with. Agricultural inflation has risen by almost 70% over the last five years but has fallen by 21% relative to this time last year. Historically, agricultural inflation has tracked the oil price as rising fuel prices leading to increases in everything from fertilisers to meat. In March 2012, Brent Crude hit a record high in sterling terms of almost £80.4 per barrel. It has since fallen by 15% to £68.2 but this is still 90% above the average for 2007 *(£36.2)*. The rapid rise in food prices does not automatically lead to a significant increase in profitability. Furthermore, the oil price has been diverging from other agricultural commodities. Back in 1950 a barrel of oil was broadly in line with the price of a bushel of wheat. In the mid-1970s the ratio increased to 3:1 and stood at 10:1 in 2000. Last month, however, the price of a barrel of oil in dollars was almost 20 times the price of a bushel of wheat.

The local agricultural community may not closely follow what the IMF says. However, last week a report issued by the IMF predicted a doubling in the price of oil, in real terms, in the coming decade. This is one forecast that petrol heads and farmers the world over hope will not be realised. Outside of the oil price, the local agricultural industry will have its eyes fixed on Europe for two reasons. First, the euro /sterling exchange rate will have a significant bearing on price competitiveness, trade and incomes. The recent dip below 80p *(or £ = €1.25)*, if sustained, represents some erosion of price competitiveness. However, it remains a far cry from the €1.41 levels that prevailed in 2007/08. Last year's Single Farm Payment (SFP) yielded £267m for Northern Ireland's farmers. This broadly equates to DETI's annual budget. This year's SFP will be set closer to 80p rather than 86.7p attained last year. Finally, reform will be a major feature in Europe in the years to come, not least in the field of agriculture and reform of the CAP.

Due to these challenges, investors, won't be counting their chickens, but neither are they unlikely to look a gift horse in the mouth. Whilst not short of volatility and challenges, the grass is certainly greener on the agri-food sector side of the fence.

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