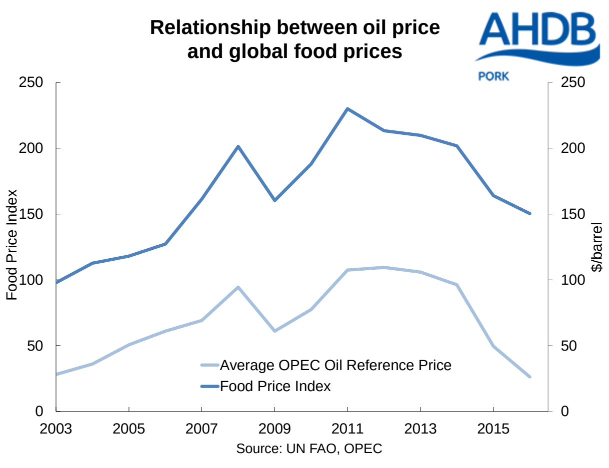
Uncertainty in global markets could present opportunities

A slowdown in growth in China, weak commodity prices, low bond yields, weak global trade and a fall in the oil price have combined to create uncertainty in global financial markets and increase volatility, with implications for the pork market.

China's growth has slowed as it attempts to transition from a state-led investment and manufacturing economy to one more dependent on consumption and services. This was widely predicted and should have come as no surprise to the markets. However, it has been the pace of the slowdown that has made investors nervous. It is also widely accepted that China's official figures may overstate growth, making the slowdown even sharper than reported.

This drive to a more consumption-led economy may present more trade opportunities with China. There has already been a significant increase in the amount of pork and offal exported to China, exacerbated in 2015 by a significant reduction in the Chinese domestic herd. Many Chinese consumers are showing a preference for imported pork, amidst several domestic health scares. So a push towards a more consumer-led society with a predilection for imported products over domestic could be a continued source of opportunity for the UK pig industry.

China has enjoyed a prolonged period of growth, with huge government-funded infrastructure projects fuelling demand for oil, steel and other commodities. These have been hard hit by the slowdown, meaning a drop in commodity prices. Along with weak industrial output, this has resulted in a slowdown in global trade. Combined with an OPEC decision not to control the supply of oil but maintain its market share, driving higher cost producers out of the industry, oil prices have dropped dramatically, reaching lows of $27 a barrel.

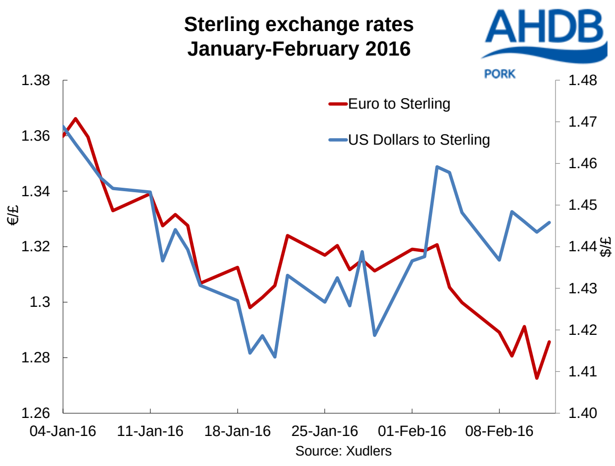


There has historically been a link between oil prices and global food prices. With the oil price falling over the past two years, the food price index has followed the same trend. Whilst this means that producers have received a lower price for their product, it has also translated into lower input costs.

For pig producers, feed costs have reduced significantly over the last three years and there have also been lower costs for fuel, heating and lighting. So, whilst falling pig prices have not been welcomed, the blow has been slightly softened by decreases in the cost of production.

The lower price of oil for transport, heating and lighting should have given households an unexpected boost in their real incomes, with cash freed up to spend on other goods and services. With this benefitting the least well off the most, economic theory would suggest that this would boost consumption. However, for this to happen, all other things should remain equal. In reality, with interest rates at historic lows and share prices tumbling, consumers everywhere have been very cautious about any increases in spending.

Here in the UK, the prospect of Brexit has compounded uncertainty on the markets, affecting the exchange rate. Sterling has weakened against the euro since mid-January and also lost ground against the US dollar, as the Federal Reserve announced an interest rate rise and investors looked for "safe" options amidst market volatility.



The weakening of the pound against the euro has come as some welcome news for UK pig producers. It has resulted in the narrowing of the gap between EU and UK prices, helping to make UK pork more competitive both domestically and abroad. The UK price premium has been historically high over the past two years but has been falling of late and now sits at a more normal 12p/kg.

In summary, although worrying at first sight, the current economic uncertainty could present opportunities for the UK pig industry. Although China's growth is slowing, it is moving towards a more consumer-led market with an appetite for imported products. Falling commodity prices have translated into decreased costs of production, helping to soften the blow of falling pig prices. The UK's impending EU referendum has compounded uncertainty on the markets, weakening the pound against the euro and the US dollar, thereby making UK pork more competitive both domestically and abroad.