EU market recovery still some way off

There is little doubt that the weakness of UK pig prices over the last two years has been affected by the low prices in the rest of the EU. These have been driven by rising production which coincided with subdued consumer demand for pork across Europe and the loss of the Russian export market. Strong demand from Asian export markets and the weak euro have helped to prevent prices falling even further. Nevertheless, EU prices have recently hit their lowest level since EU expansion in 2004.

There was a widespread expectation that, despite relatively low feed prices, the weakness of the pig market would lead to many producers reducing their herds or leaving the industry altogether. Results from the December 2015 pig census confirm that this has indeed happened in a number of Member States. However, expansion elsewhere, notably in Spain, has limited the reduction.

The net result is that the total number of pigs in the EU in December was actually slightly higher than a year earlier, with all categories of feeding pigs stable or growing. This suggests that the number of pigs available for slaughter in the early months of 2016 will have been slightly above the levels of last year.

EU pig census results, December

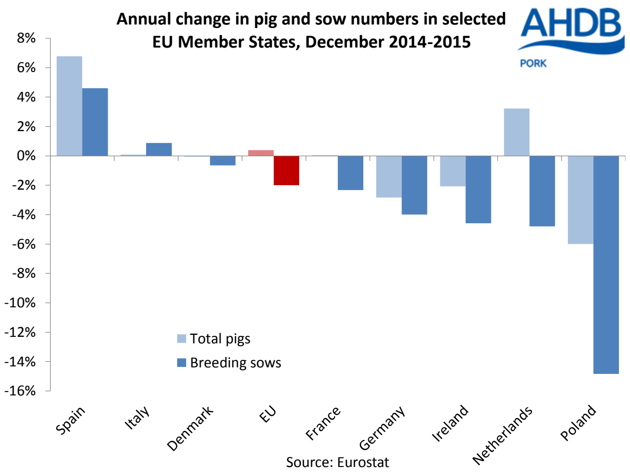
	2014	2015	% change
	000 head		
Total pigs	**148,330**	**149,069**	**+0.5**
Female breeding herd	**12,542**	**12,328**	**-1.7**
In-pig sows	6,998	6,925	-1.1
In-pig gilts	1,605	1,507	-6.1
Other sows	2,432	2,406	-1.1
Maiden gilts	1,506	1,490	-1.1
Boars for service	204	203	-0.6
Other pigs	**135,584**	**136,539**	**+0.7**
Under 20kg	41,831	41,801	-0.1
20-50kg	33,949	34,301	+1.0
50-80kg	27,546	27,658	+0.4
80-110kg	24,224	24,241	+0.1
110kg or over	8,034	8,538	+6.3

Source: Eurostat

If carcase weights have continued on their recent upward trend (as has been the case in the UK), there will have been more pig meat on the EU market. The EU's Private Storage Aid (PSA) scheme removed some product from the market and export sales to key Asian markets like China and Japan have reportedly remained strong. Despite this, the increased supply helps to explain why EU pig prices have struggled to recover from their current low level.

The Census results do show a decline in the EU breeding herd in the year to December 2015. However, the drop was less than 2% overall. Looking at the figures in more detail shows a similar 2% fall in the number of in-pig sows and gilts, although there was a bigger fall for the latter. However, maiden gilt numbers were only down 1%, which doesn't support a dramatic fall in sow numbers in the near future. The likelihood of further productivity gains means that this is small enough to prevent the number of pigs being produced falling dramatically. Therefore, the hoped for decline in EU production may be some way off yet.

At Member State level, the census figures show a mixed picture. Most key producing countries recorded declines in their breeding herds. In some cases, particularly in Eastern Europe, the declines were significant. This is particularly true in Member States which still have a large number of small producers, such as Poland and Slovakia, suggesting the loss of many of these farms.

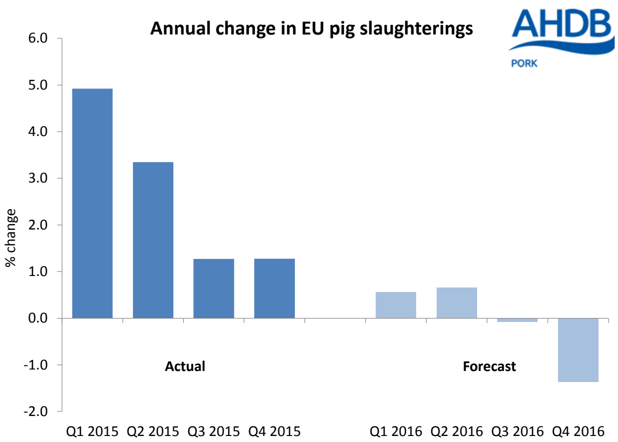


However, these losses were largely offset by the ongoing rapid expansion of the Spanish herd. The number of sows in Spain was again up by nearly 5% on the year, consolidating its position as the EU's largest breeding herd. Indeed, so rapid was has the growth been that there are now more pigs in Spain than Germany, although imports of weaners means the latter will still slaughter the most pigs.

The extent of vertical integration in the Spanish industry has given it some protection against low pig prices. It has also helped it to keep its production costs down, making it the lowest cost producer in the EU. Significant recent capital investment also makes it more difficult for producers to scale back production, as debts need to be serviced. This is also a factor for many of the larger producers elsewhere in Europe, helping to explain why supply levels have been slow to respond to the low prices. The increasing consolidation in EU pig production suggests that this may be a persistent feature, making EU production less responsive to price signals and leading to increased price volatility.

Based on the December census results, the EU Commission's forecasting working group for pig meat updated its forecasts at a meeting in Brussels in mid-March. The new estimates from group members, coupled with official ones from those Member States not represented at the meeting, confirm the expectation that EU pig slaughterings in the first half of 2016 will be slightly higher than in the same period of 2015. Growth is expected to be less than 1%, though, noticeably slower than during the first half of 2015.

For the second half of the year, the latest forecasts show production starting to fall back, albeit only marginally in the third quarter. By the final three months of the year, slaughterings are predicted to be over 1% below their level in 2015, although, as always, there is less certainty about the exact position further into the future.

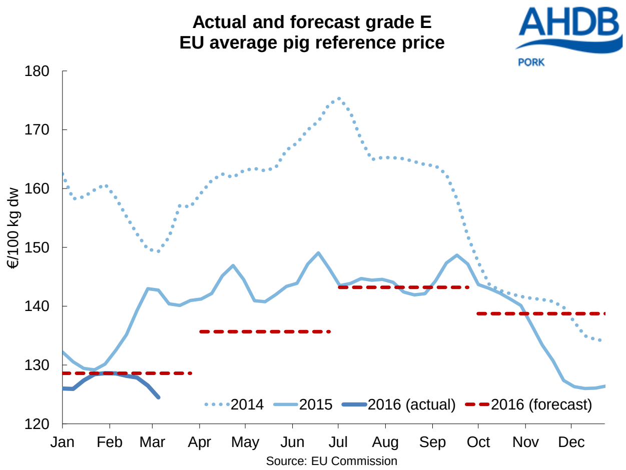


Sources: Eurostat, EU Commission pig meat forecasting working group

The group's forecasts suggest the EU market will remain well supplied over the coming year. Slaughterings for the year as a whole are expected to be virtually unchanged and any rise in carcase weights would mean that production actually increases. Only towards the end of the year are supplies likely to fall below last year's levels and, even then, probably only marginally once weights are taken into account.

That means that the hoped for tightening of the EU market still looks to be some way off, unless there is a significant increase in demand. However, prospects for the demand side of the equation don't look particularly positive. Within the EU, consumer confidence remains fragile and retail meat purchases have been subdued as a result. Pig meat, particularly fresh pork, has suffered more than some other meats. Despite falling prices, volume sales have been down in most of the main markets, with the exception of Spain, based on consumer panel data. There is little sign of a reversal of fortune in figures for early 2016 either.

The other component of demand is exports. The euro remains relatively weak against the US dollar, although it has strengthened a little since late 2015. However, it has lost ground against the Brazilian real, a more important factor now that Brazil has direct access to the key Chinese market. With the global market still well supplied and signs that Chinese demand may ease back from the inflated levels of late 2015, matching last year's export performance may be challenging. Of course, this could be helped if progress can be made on the Russian import ban, at least for products, such as fats and offals, not covered by the political embargo.



Source: EU Commission

With the balance between supply and demand remaining unfavourable, it is little surprise that EU prices have remained under pressure in early 2016. Any support during the period of the PSA scheme has not been sustained. The EU's forecasting working group also produces quarterly price forecasts for the coming year. These anticipate that the market will remain challenging in the year ahead. Prices are forecast to rise during the spring and summer, assuming reasonably favourable seasonal demand. However, they are not expected to get any higher than they did last summer. With supply tightening to some extent in the latter part of the year, prices are not expected to fall back as sharply as in the last two years, meaning they could move above year earlier levels. Nevertheless, the market is set to remain well below the levels seen in 2014 and before.

How these trends affect the UK market will, of course, also depend on the exchange rate between the pound and the euro. At last summer's peak, the EU average price was equivalent to less than 110p/kg. Since then, the pound has weakened and, at current exchange rates, the peak would have been equivalent to around 115p/kg. If, as widely anticipated, the pound weakens further in the run up to the EU referendum, the EU price may be even higher in sterling terms. This could give some support to the domestic market, even in advance of any supply tightening on the continent.

The latest forecasts confirm that expectations of a recovery in the EU market in the short-term may be premature. This may add weight to calls for further market support measures from the EU Commission, such as reopening Private Storage Aid. However, even with these implemented, it looks likely to be another difficult year for EU producers.