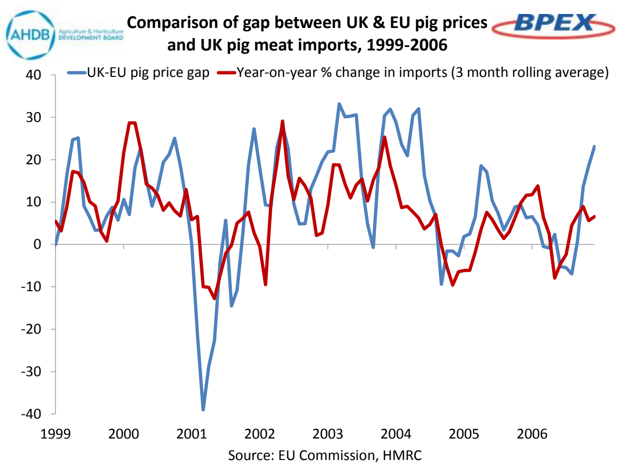
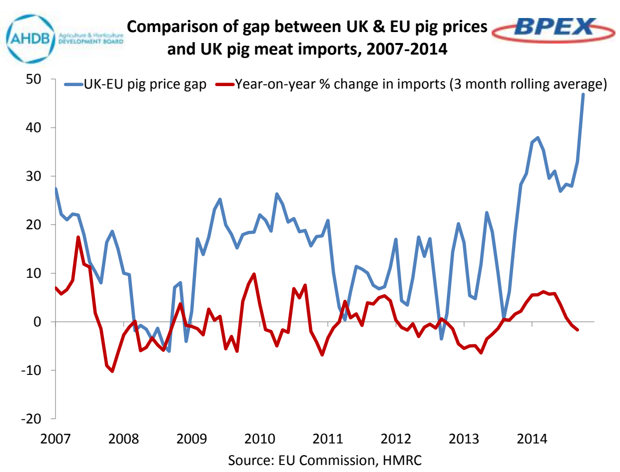
Has the link between UK and EU pig prices been broken?

This year, the gap between UK and EU pig prices has risen to unprecedented levels. This might have been expected to lead to a surge in pig meat imports but they were only up 4% in the first three quarters of the year. It might also have led to a fall in exports as they struggled to compete on price; in fact, exports are up 11% for the year to date. So is the UK market now immune to developments in the rest of the EU?

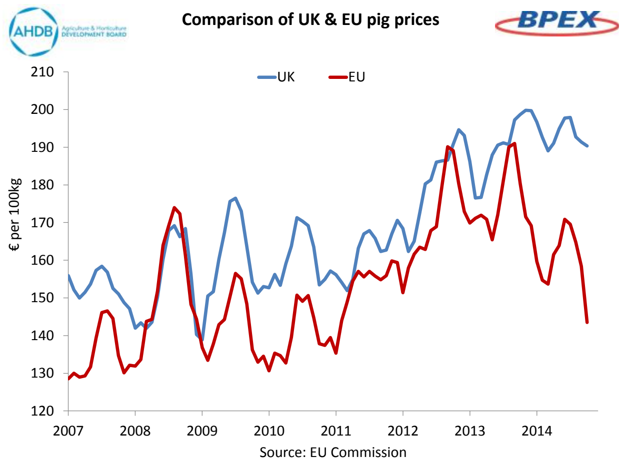
Between the late 1990s and 2006, the level of UK pig meat imports was clearly linked to the gap between UK and EU pig prices. During this period, imports were generally rising as domestic production fell. However, as the price gap increased, imports usually accelerated and when the gap decreased, growth slowed or even reversed. Trade was disrupted in 2001 and 2002 following the FMD outbreak, which caused a short-term deviation from this pattern.



However, since 2007, imports have broadly levelled off and the relationship between the price gap and import levels appears to have broken down to a large extent. Now, when the gap between UK and EU pig prices changes, the level of imports doesn't seem to be greatly affected. Even this year's exceptional and sustained price gap has not been sufficient to stimulate imports to any significant extent. Equally, in 2008 when EU pig prices were generally higher than UK ones, imports were only slightly lower than the year before.



Prior to this year, the biggest gap between monthly pig prices in the UK and EU was 33 euro cents in March 2003. In the ten years up to 2013, the gap averaged just 11 cents. Although the difference between the two prices fluctuated in the short-term, between 2007 and late 2013 it was normally between 5 and 20 cents and rarely stayed outside this range for more than two months in a row. An exception was 2008, when the very rapid fall in the value of the pound kept EU prices above UK ones for a sustained period.



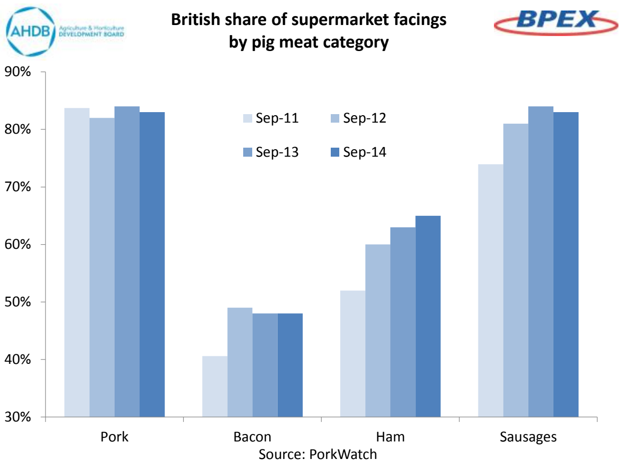
This suggests that, between 2007 and 2013, the UK market was responding to EU prices in a way which ensured that import levels didn't change significantly. When the price gap got too big, the threat of higher imports was sufficient to mean that UK prices fell back, closing the gap before import levels had time to rise too much. Conversely, when the gap shrank and UK pork was relatively cheaper, there was no price benefit to using imported pig meat and demand for UK pigs rose. This pushed UK prices higher, reopening the gap and ensuring that imports continued.

However, over the last 12 months, the relationship between UK and EU pig prices seems to have broken down. The difference between the two prices has been 27 cents or higher in every month since last November. It has surpassed the previous record high in four months and in October it was nearly 47 cents, easily the highest figure ever.

So, what has changed? The main answer appears to be that UK pork buyers have shown an increased preference for sourcing domestically. In the past, their preference for British pork was price dependent. If imported pig meat was cheap enough, relative to the UK equivalent, they were prepared to switch. That no longer seems to be the case for many.

Retailer commitment to UK pig meat is confirmed by figures from AHDB/BPEX's bi-monthly PorkWatch survey. This measures how much supermarket shelf space is allocated to British products across each of the main pig meat categories. It reveals that the British share has risen over recent years for most categories. Latest figures show that between

September 2013 and September 2014, there was little change in the position, despite the pig price gap rising from 6 cents in September 2013 to 33 cents a year later.



The change of attitude can probably be attributed to the horse meat revelations of early 2013. This led to a desire among the major retailers to shorten and simplify supply chains, to minimise the risk of similar issues arising in the future. More retailers have committed to sourcing all their fresh pork from the UK. Even those which haven't are looking to procure as much British pork as they can. Other pig meat products are also affected by the increased preference for UK sourcing, although carcase balance issues mean a higher proportion of bacon and ham still has to be imported.

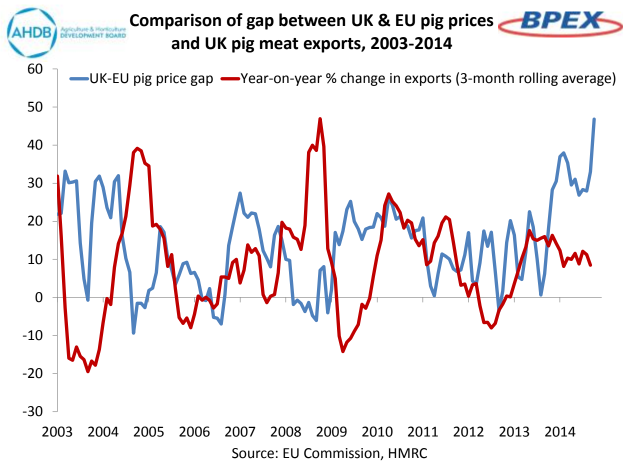
Whether buyer commitment to UK pig meat will stay strong in the face of the sustained price premium remains to be seen. The record price gaps in early 2014 certainly didn't lead to a dramatic ramping up of imports. However, the sharp fall in EU prices this autumn has taken the differential to new levels. The impact won't be clear until trade data for October and November are published. However, there will be a point when the price gap becomes too large for buyers to ignore. It remains to be seen whether we have reached that point yet.

The fact that UK pig prices have fallen steadily during the autumn suggests there may be some more imported pig meat on the market. However, in mid-November the gap to EU prices remained nearly 45 cents, suggesting that any increase in shipments probably remains modest.

This year's widening of the gap between UK and EU prices is mostly due to the weak EU pig market. However, exchange rate movements have also contributed. Last autumn one euro was worth about 84p. This year, it was around 79p. Had the exchange rate not moved and pig prices been the same, the gap between EU and UK prices in October would be 33 cents – still among the highest ever but not as extreme.

The change in the euro-sterling exchange rate in the last year has been more down to the weakness of the euro than the strength of the pound. Against other major currencies, including the US dollar, the pound has been little changed over the last year or so, even weakening somewhat against the dollar in recent months. This means that, from an export point of view, recent exchange rate movements will have had more effect on shipments to the rest of the EU than those to non-EU markets.

However, with most exports destined for other EU Member States, the gap between UK and EU prices might still be expected to have an influence. Indeed, historically, this appeared to be the case, to some extent at least, with exports peaking when the gap was lowest. It is perhaps unsurprising that the relationship is less strong than for imports, though, given that exports are mostly made up of cuts with limited value on the UK market. Prices for these cuts may not follow the trend of pig prices, being driven more by demand on export markets.



However, as for imports, the relationship between relative prices and export volumes seems to have broken down completely, in this case since around 2010. For most of the period since then, exports have risen strongly regardless of the price premium for UK pigs. In part, this may be due to the rise in third country exports, which accounted for 18% of shipments in 2010 but 32% so far in 2014. These exports are less sensitive to pig price movements than those to the EU.

The big question now is whether import and export trends will remain immune to the gap between UK and EU prices, as they appear to have been in recent years. For exports, the answer may well be yes – future trends will mainly be driven by demand, particularly from emerging markets in Asia. For imports, the answer is less certain. It will largely depend on how the big pork buyers, mainly the leading retailers, respond. If their commitment to sourcing from the UK wavers then the price gap will have to close to avoid a sharp rise in imports (which would, in turn, reduce prices). However, if support for UK pork remains strong then supply and demand on the domestic market will remain the key price drivers, with the EU market having only a limited effect.